"Dedication of Production" Clauses: Challenges in Ascertaining Interests in Natural Gas Gathering and Processing Agreements in Bankruptcy

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I. Introduction

The natural gas spot prices in 2016 at the Henry Hub included some of the lowest annual averages since 1999, following a prolonged depression of prices since 2008.[1] This collapse in prices—primarily driven by warmer-than-normal annual temperatures and changing natural gas demand in 2016[2]—resulted in over eighty oil and gas production companies filing for bankruptcy from 2015 to 2016.[3] In some production areas, the impact of low prices were also deeply felt by midstream gathering and processing companies who contract with producers to provide storage and refining services near wellheads before sending the gas to market.[4]

This sudden insolvency pressured many producers to file petitions for Chapter 11 bankruptcy. Chapter 11 provides financial relief by allowing companies to reorganize and shed certain debt and contractual obligations to enable the debtor to operate more efficiently post-bankruptcy.[5] The mechanism for shedding burdensome debt obligations appears in section 365 of the United States Bankruptcy Code ("Bankruptcy Code"), and comes into play during the creation of the bankruptcy estate.[6] Section 365 outlines the types of obligations debtors may retain as part of their ongoing obligations post-bankruptcy.[7] Under section 365, a debtor may terminate its pre-petition executory contracts by "rejecting" them from inclusion in the estate.[8] This functions as the debtor's declaration that it will not perform its remaining obligations. This leaves the debtor's creditors and contractual counter-parties with only one option: filing a breach of contract claim against the estate, which is often repaid by only cents on the dollar, and only *after* the debtor satisfies its secured creditor claims. In contrast, a debtor must "assume" its prepetition non-executory contract obligations into the bankruptcy estate, requiring the debtor to repay a higher proportion of its prepetition debt obligations and perform its outstanding contractual obligations. Such non-executory contracts include those arising under real covenants.[9] Generally, assumption permits repayment in full, with higher priority than unsecured creditor claims.[10]

While bankruptcy provides debtors an equitable remedy during times of financial hardship, the influx of filings by gas production companies has raised questions regarding the proper treatment of certain contractual clauses present in petitioners' midstream gathering and processing agreements.[11] Specifically, the confusion surrounds the interplay of section 365 and the interpretation of "dedication of pro-

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1. *Natural Gas Prices in 2016 Were the Lowest in Nearly 20 Years*, U.S. Energy Info. Admin. (Jan. 13, 2017), https://www.eia.gov/todayinenergy/detail.php?id=29552 [https://perma.cc/68LF-A2DG].
2. *Id.*; Christopher Castillo et al., Anatomy of a Commercial Gathering Project: Midstream Oil & Gas From the Upstream Perspective, 3-1 Rocky Mountain Min. L. Found. (2018). *See also* Whit Keuer, *North American Midstream Strategy in a Time of Uncertainty*, Bain & Co. (Aug. 23, 2017), https://www.bain.com/insights/north-american-midstream-strategy-in-uncertainty/ [https://perma.cc/B4J3-DXL6].
3. *See Cheaper Oil: Winners and Losers*, The Economist (Oct. 23, 2014), http://www.economist.com/news/international/21627642-america-and-its-friends-benefit-falling-oil-prices-its-most-strident-critics.
4. *See* Keuer, *supra*, note 2.
5. *See* N.L.R.B. v. Bildisco & Bildisco, 465 U.S. 513, 528 (1984) (holding that "[t]he fundamental purpose of reorganization [Chapter 11] is to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources.").
6. *See* 11 U.S.C. § 365(h)(1)(B) (2012).
7. *See generally id.* § 365(a)–(b)(1).
8. *Id.* § 365(a).
9. *Id.*
10. *See generally* In re Network Access Sols., Corp., 330 B.R. 67 (Bankr. D. Del. 2005) (discussing impacts of assumption on the claims of unsecured creditors).
11. *See, e.g.*, Charles Sartain & Lydia Webb, *Rejecting Midstream Agreements in Bankruptcy—The Journey Continues*, Gray Reed (Apr. 11, 2017), https://www.energyandthelaw.com/2017/04/11/rejecting-midstream-agreements-in-bankruptcy-the-journey-continues/ [https://perma.cc/UM4G-WLAU]. Unless otherwise indicated, "gathering agreements" refers to natural gas gathering and/or processing agreements.

duction" provisions.[12] When these provisions are interpreted as involving a property interest, such as when they are read together with a conveyance of a tract of the producer's leasehold for purposes of constructing and operating a gathering system, the debtor may be precluded from rejecting the contract. If no property interest is involved, then the bankruptcy court will generally treat the entire contract as an executory contract, whose obligations survive post-bankruptcy.[13]

Dedication provisions are a type of exclusive dealing provision, representing a producer's promise that all gas produced from the specified acreage will be supplied to the contracting midstream counterparty for gathering and processing. These commonly used provisions are critical for protecting a midstream company's investment in constructing and operating facilities on the producer's leased property. Despite this commonality, the Bankruptcy Code makes no mention of acreage dedication clauses nor defines the term "dedication." This statutory omission, coupled with the bespoke nature of these contracts and the governance of contracts and oil and gas rights under state law, and the language of these provisions have caused interpretive challenges in the bankruptcy context. Traditionally, courts have appropriated the common law property doctrine of real covenants (developed under state law) to the federal Bankruptcy Code to construe dedication clauses as non-executory contracts, thereby precluding rejection.[14] In 2016, however, Sabine Oil Company ("Sabine"), a producer-debtor, usurped this notion when it succeeded in getting its midstream contract rejected as an executory contract, leaving its midstream partner to suffer substantial losses in sunk investment costs.[15] In wake of this groundbreaking decision, other petitioners have raised the same challenge, making the future treatment of dedication of production provisions uncertain.[16]

As *In re Sabine Oil Company* shows, the implications of this uncertainty have major financial repercussions for the parties involved.[17] Uncertainty also stifles investment in the midstream sector, as investors may not be willing to bear the risk of losing the value of their midstream contracts through their counterparty's voluntary bankruptcy. Hence, resolving the issue of whether these provisions invoke property interests or are purely executory contracts is critical to fostering continued investment in domestic natural gas production.[18]

This Note focuses on the interpretative issues raised in midstream gas agreements containing dedication of production clauses including the midstream operator's obligation to purchase unrefined gas from the producer. This Note proposes to resolve this legal question by adopting an amendment to the U.S. Bankruptcy Code specifically defining and categorizing dedication provisions, thereby avoiding the interpretative issue presented in these recent Chapter 11 proceedings. Part II of this Note provides an overview of the natural gas industry, its unique financing challenges, and recent cases raising concerns of predatory bankruptcy. Part III provides an overview of relevant portions of the Bankruptcy Code and describes potential treatment of dedication provisions thereunder. Part IV proposes to amend the Bankruptcy Code, offering statutory language to help clarify recent inconsistencies in judicial interpretation of contractual acreage dedication clauses. Specifically, this Note proposes to amend sections 101 and 365 to provide statutory definitions of the contractual phrase "dedication of production" and of the common law doctrine of real covenants that can be applied uniformly nationwide. Finally, Part V concludes with a short summary of the preceding discussion.

II. Overview of the Natural Gas Midstream Industry

A. *Midstream Gathering and Processing Agreements*

Despite its widespread use,[19] financing fossil fuel production is generally not well understood outside of the industry. Although gas gathering and processing agreements provide the foundation upon which producers and midstream service providers base their operations,[20] no standard lease form is required or used for operations taking place wholly within state boundaries.[21] As a result, midstream agreements can take a variety of forms and have major implications for a producer's perfection of liens, lien assignability, cure obligations, and perfection timeline inside and outside of the bankruptcy context.[22]

Among the many varieties of gas gathering agreements, three common agreement structures include: (1) a producer's

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12. *See* Brian C. Boyle, *Energy Law, in 2016: The Year in Review*, 80 Texas B.J. 19, 26 (2017).
13. *Compare* In re Montgomery Ward, L.L.C., 469 B.R. 522, 528 (Bankr. D. Del. 2012), *with* In re Buffets Holdings, Inc., 387 B.R. 115, 121 (Bankr. D. Del. 2008).
14. *See, e.g.*, Robert D. Woods, *An Uncertain Fate for Oil and Gas Midstream Agreements*, Law360 (Feb. 26, 2016, 10:16 AM), https://www.law360.com/articles/763699/an-uncertain-fate-for-oil-and-gas-midstream-agreements. Disputes concerning the proper interpretation of "dedication of production" provisions do not raise a completely novel legal question, because the basic form of midstream gathering and processing agreements (that is, a set of bargained-for exchanges to which the parties consented) invoke traditional contract law principles. As such, disputes over the interpretation and enforceability of these provisions outside of the bankruptcy context are governed by state contract law. However, given the different policy goals underlying contract and bankruptcy law, state contract law offers only limited guidance on how to interpret these provisions for purposes of bankruptcy.
15. Daniel Gill, *Sabine Oil's Rejection of Midstream Contract Affirmed*, Bloomberg BNA (May 30, 2018) https://www.bna.com/sabine-oils-rejection-n57982093092/.
16. *See* Boyle, *supra* note 12.
17. In re Sabine Oil & Gas Co., 547 B.R. 66 (Bankr. S.D.N.Y. 2016).
18. *See* Boyle, *supra* note 12. For an overview of the bankruptcy process, see David R. Kuney, *Overview of the Bankruptcy System*, *in Commercial Real Estate Defaults, Workouts, & Reorganizations*, ST055 ALI-CLE 511 (2012).
19. Deborah D. Williamson, When Gushers Go Dry: The Essentials of Oil and Gas Bankruptcy 5, (2d ed. 2016).
20. *Id.*
21. *Id.* Interstate pipeline operations, or operations that otherwise meet certain criteria, are subject to regulation under Federal Energy Regulatory Commission ("FERC"). The form of gas gathering and processing agreements falling under FERC's oversight must comply with all relevant regulations set by the Commission. *See also* Bill Wolf & Randall S. Rich, *Gathering, Processing and Other Midstream Agreements*, Energy B. Ass'n Dec. Brown Bag Meeting/Teleconference: The EBA Nat'l Gas Reg. Committee (Dec. 13, 2012), https://www.eba-net.org/assets/1/6/Gathering-Processing-and-Other-Midstream-Agreements.pdf.
22. Williamson, *supra* note 19, at 7. *See also* Castillo, *supra* note 2.

payment to the partnering midstream company described as a "dedication of production," (2) a minimum volume of gas commitment ("MVC"), or (3) one of four basic service rate structures.[23] There are a few important distinguishing features to note about "dedication of production" clauses. First, "dedication of production" clauses consist of the producer's promise to deliver all the unrefined gas it extracts from a specified portion of the subsurface mineral acreage it owns to the partnering midstream company for gathering and/or processing (as the agreement specifies).[24] Second, unlike MVC clauses, a "dedication of production" clause often provides a more favorable outcome for the producer. This is because these clauses allow producers to remain free to dedicate their remaining mineral acreage to other midstream gathering companies without subjecting themselves to liability for failing to deliver a set amount of natural gas to any single gathering partner.[25] However, the precise risk allocation contemplated in any given "dedication of production" clause depends upon a number of issues, including the specific shale play at issue, the parties' particular knowledge of the mineral wealth of the subject area, and each party's willingness to allocate the costs of midstream infrastructure. Lastly, combining "dedication of production" clauses and various rate provisions allow producers to contract for bundled services.[26] These services may include remote operation and monitoring of wells, supervisory control and data acquisition ("SCADA") services,[27] and/or third-party compression services to uprate[28] gas pressure at pipeline connection points.[29]

Adding to the complexity is the potential for the parties to overlay these service agreements with provisions requiring midstream service providers to redeliver processed gas to the producer or the producer's designee before ultimately going to market.[30] These provisions function as risk-sharing mechanisms for producers who undertake the risk of drilling a potentially unprofitable well.[31] Hence, midstream agreements often intertwine language resembling a conveyance of a property interest in extracted gas with executory contractual language describing the terms of performance. Given this entanglement of property and contract law, both producer-debtors and their creditors present persuasive arguments for their desired treatment of dedication provisions under section 365.

B. *Project Financing and Predatory Concerns*

In the oil and gas industry, a producer's filing of Chapter 11 bankruptcy is not alarming on its face. This is because production projects depend heavily on the producer's ability to front-load capital for the construction of wells and pipeline infrastructure many years before the well begins operation. Moreover, the nature of these projects requires a continued uninterrupted flow of operating capital throughout the initial drilling process, which often lasts years before the well turns a profit.[32] Indeed, industry experience reveals that a producer's profitability in domestic onshore drilling projects heavily depends on two factors: the market prices realized for their products, and the cost and productivity of newly developed wells.[33] Given the economic scale of drilling operations, most producer-debtor bankruptcies are the result of liquidity crises due largely to cyclical price fluctuations, often exacerbated by debt financing.[34]

In short, even a seemingly small drop in fossil fuel prices can have a major impact on the perceived creditworthiness of producer looking to obtain more debt financing, thereby severely impairing its ability to obtain cash through new debt instruments.[35] This, in turn, adversely affects its ability to pay operating expenses. If severe enough, this cash drought may cause a producer to mitigate its losses by temporarily reducing or ceasing production altogether. A stall in production further exacerbates this problem.[36] Hence, a small reduction in overall cash flow from lower fossil fuel prices can derail a producer's ability to fund its operations, renew its leases, and pay royalties.[37] Most importantly, reduced cash flows inhibit a producer's ability to perform routine contractual obligations, such as providing interrupted gas supply to its midstream partners under volume throughput commitments.[38] This inability to get the gas to market, in turn, reduces the producer's ability to make deficiency payments to its midstream service providers for interrupting the supply of gas.[39]

With this understanding of the financial sensitivities of production, there has been growing concern that producers

23. Typical rate structures include: fixed fee, sharing (in-kind), variable, and cost-of-service. Wolf & Rich, *supra* note 21, at 10.
24. For an example discussion of a "dedication of acreage" agreement, see Press Release, MarkWest Energy Partners, L.P., MarkWest Energy Partners Announces Significant Long-Term Fee-Based Agreements With Chesapeake Energy and Antero Resources to Expand Its Marcellus Shale Midstream Facilities in West Virginia (May 4, 2012), http://investor.markwest.com/phoenix.zhtml?c=135034&p=irol-newsArticle_print&ID=1691623 [https://perma.cc/2XN8-FSM3].
25. *Id.*
26. *Id.*
27. *Id.*
28. *Id.*
29. Wolf & Rich, *supra* note 21, at 5.
30. *Id.*; *see also* Castillo, *supra* note 2.
31. Williamson, *supra* note 19, at 22. *See also* Castillo, *supra* note 2.
32. Considering "the costs of onshore oil and natural gas wells using the following cost categories: land acquisition, capitalized drilling, completion, and facilities costs; lease operating expenses; and gathering processing and transport costs," the "[t]otal capital costs per well in the [Bakken, Eagle Ford, Permian Basin and Marcellus plays ranged] from $4.9 million to $8.3 million, including average completion costs that generally fell in the range of $2.9 million to $5.6 million per well. However, there is considerable cost variability between individual wells." *Trends in U.S. Oil and Natural Gas Upstream Costs*, U.S. Energy Info. Admin., 1–2 (Mar. 23, 2016), https://www.eia.gov/analysis/studies/drilling/pdf/upstream.pdf [hereinafter *Oil and Gas Upstream Cost Study*]; Williamson, *supra* note 19, at 5.
33. *Oil and Gas Upstream Cost Study*, *supra* note 32, at 1.
34. Williamson, *supra* note 19, at 5. "Debt financing" is the practice of "rais[ing] money for working capital or capital expenditures by selling bonds, bills or notes to institutional investors. In return for lending money, the institutional investors become creditors and receive a promise that the principal and interest will be repaid." *Debt Financing*, Investopedia, http://www.investopedia.com/terms/d/debtfinancing.asp [https://perma.cc/U95C-54R2] (last visited Apr. 4, 2017, 12:15 PM).
35. *Id.*
36. *Id.*
37. *Id.*
38. Castillo, *supra* note 2.
39. *Id.*

may be engaging in predatory bankruptcy in the wake of the 2014 market downturn, given the increased number of filings submitted only months after entering into long-term and multimillion dollar midstream agreements.[40] The reasoning behind this concern is simple: given that natural gas production is capital-intensive, requires significant preparation to prove project's long-term financial viability (creditworthiness) to obtain debt-financing, and can take years to secure oil and gas leases with individual landowners and obtain the requisite permits and ancillary service contracts, one would not expect a producer to abruptly abandon its efforts mere months after securing its midstream contract, itself one of its most crucial steps in ensuring a producer's gas reaches market, unless the situation was truly dire. Although bankruptcy is available to redress current financial constraints rather than future projections, the concern that some producers are engaging in predatory bankruptcy rests on the idea that some producers appear to be filing for Chapter 11 despite promising viability of the shale play upon which their well is located. While there have been a number of cases raising suspicions of predatory bankruptcy, an exploration of those cases is beyond the scope of this Note. Rather, this Note focuses on the preeminent case that first brought to light the difficulties in ascertaining the proper legal treatment dedication provisions in the context of Chapter 11 proceedings.

C. *Investor Disruptions in* Sabine Oil

In *In re Sabine Oil & Gas Corporation*, Judge Chapman rejected Nordheim Eagle Ford Gathering, LLC's ("Nordheim") creditor claims requesting that Nordheim's two contracts (hereinafter "Nordheim Agreements") be included in Sabine's bankruptcy estate as covenants running with the land under section 365.[41] Together, these contracts obligated Nordheim to:

> (1) gather, treat, dehydrate, and re-deliver gas to Sabine Oil; and (2) perform substantially similar tasks with respect to condensed liquid hydrocarbons and other non-gas liquids. Sabine Oil, on the other hand, was required to pay certain gathering fees and either deliver minimum amounts of gas to Nordheim or make deficiency payments if these threshold amounts were not met.[42]

Additionally, Nordheim "agreed to construct, at its sole cost and expense, a gathering system of pipelines and treatment facilities to provide certain agreed-upon services."[43] To facilitate this construction and operation, Sabine agreed to convey to Nordheim a tract of land located on Sabine's lease for a ten-year term.[44] Notably, each of the Nordheim Agreements contain provisions describing the instrument as a "covenant running with the [land]" within its allotted acreage and provides that they are "enforceable by Nordheim against Sabine, its affiliates, and their successors and assigns."[45] Together, the Nordheim agreements obligated Sabine to "dedicate" to the "performance" of the agreements certain leases held by Sabine as well as the natural gas produced from the wells located therein.[46]

Nordheim's relationship with Sabine began when Sabine inherited the Nordheim Agreements following Sabine's merger with another oil corporation, which commissioned Nordheim to expend $84 million to build the gathering system to be used by Sabine.[47] Sabine's decision to reject these agreements as executory contracts prevented Nordheim from recovering funds already spent in constructing and operating the infrastructure needed to move unprocessed natural gas from the wellhead.[48] This effectively allowed Sabine, as the producer-debtor, to benefit by lowering the total amount of its post-bankruptcy debt obligations.[49]

As *Sabine* suggests, the ability for a producer to use Chapter 11's estate-creation procedures to engage in predatory activity as a means of circumventing its contractual obligations

> is problematic for midstream companies because their own debt service may be dependent on legacy contract revenue levels, and [the midstream companies] could default if that revenue is curtailed . . [yet f]rom the producer's perspective, contract rejection may be a high-stakes bluff because the oil and gas leases usually terminate if the production stops for an extended period, and the producers need the pipelines in order to continue production.[50]

Unfortunately, Judge Chapman's decision does "not resolve anything other than to point out that a rejection proceeding under [section] 365 is probably not the appropriate method of divesting a restrictive covenant. Debtors will likely look for alternatives."[51]

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40. Mark Pfeiffer, *Will the Pipeline Continue to Flow After Sabine? Oil and Gas Bankruptcies Expose Limitations in §365*, 35 Am. Bankr. Inst. J. 38 (July 2016); Miki Kolobara, *Bankruptcy Court Allows Rejection of Midstream Gathering Agreements*, Oilpro (Mar. 19, 2016), http://oilpro.com/post/25741/bankruptcy-court-allows-rejection-midstream-gathering-agreements; Loretta Cross & John Baumgartner, *How Credit Bidding is Impacting Oil and Gas Bankruptcy Recoveries*, Stout Risius Ross (Sept. 1, 2014), http://www.srr.com/article/how-credit-bidding-impacting-oil-and-gas-bankruptcy-recoveries [https://perma.cc/FB3E-NYTC] (Although beyond the scope of this discussion, a secondary predatory concern involves credit-bidding: the process by which secured lenders can "choose to participate in the auction or sale of the collateral that secures their loans using the outstanding loan balance as their currency . . . [a]s many bankruptcies today result in a sales process, either through a [§] "363 auction" or a sale through a plan" under § 1129. This creates the potential for abuse when "used as a defensive strategy by lenders to protect the value of their collateral from being sold at artificially low or distressed prices." This process has come to be known as the "Loan to Own" strategy).
41. In re Sabine Oil & Gas Corp., 547 B.R. 66, 79–80 (Bankr. S.D.N.Y. 2016).
42. *Id.* at 70.
43. *Id.*
44. *Id.*
45. *Id.*
46. *Id.*
47. *See* James Roberts, *Trouble Down the Pipeline? What Sabine Oil & Gas Corp. May Mean for the Midstream Service Sector*, Lexology (May 24, 2016), https://www.lexology.com/library/detail.aspx?g=2d632978-89cf-4ff6-916c-acca99075a25 [https://perma.cc/SC6H-FH95].
48. *See* John Stoelker, *Pain on the Way to the Pump: Rejection of Executory Contracts and the Midstream Sector: An Analysis of* Sabine Oil & Gas, MDM&C: Bankruptcy Blog (Apr. 26, 2016), https://bankruptcyblog.mdmc-law.com/index.php/category/executory-contracts/ [https://perma.cc/V4CP-VD8M].
49. Pfeiffer, *supra* note 40. *See* Roberts, *supra* note 47.
50. Pfeiffer, *supra* note 40, at 1.
51. *Id.*

III. Midstream Agreements in Chapter 11 Bankruptcy

A. *Straddling Jurisdictional Lines*

For parties seeking the protection of their contractual interests under section 365, whether midstream agreements qualify as executory contracts under the Bankruptcy Code remains "a question of federal law," and yet whether they create "a real property interest (as a part of non-federal lease) is a question of state law."[52] As such, the bankruptcy judge in *Sabine* had to determine whether bankruptcy, federal, or state court is the proper forum to adjudicate this issue.[53] Because the bankruptcy court (an Article I court) itself has no jurisdiction outside of what Congress has vested in it, some argue that it should not be given any more authority than what has been specifically granted by Congress: namely, the nonexclusive subject matter jurisdiction over bankruptcy proceedings that it shares with the U.S. district courts, which may "refer" bankruptcy matters originally arising in their courts to the bankruptcy court.[54] These proponents argue that bankruptcy judges may only hear "core" proceedings or issues that deal directly with the bankruptcy proceeding.[55] Others, however, believe bankruptcy judges may hear "non-core" matters that do not arise under bankruptcy law, despite the fact that their resolution relates to the bankruptcy.[56] The substantial case law addressing the issue of which non-core matters bankruptcy judges may properly hear indicates that this question continues to present challenges to bankruptcy participants.[57]

Despite these jurisdictional questions, many bankruptcy judges have not hesitated to opine on the state law (i.e., non-core) matters, potentially creating more confusion and inhibiting uniformity in the application and interpretation of state laws.[58] Thus, the issue of how to define and categorize the interests and rights created in dedication clauses as they apply to section 365 remains an unresolved question of statutory interpretation across bankruptcy, federal, and state courts. As discussed in Part IV, this Note attempts to obviate this jurisdictional question by streamlining the adjudicatory process into the bankruptcy court for more efficient and uniform resolution.

B. *Availability and Implications of Assumption or Rejection*

Underlying the Bankruptcy Code's statutory scheme are policies concerned with granting the debtor and his creditors fair treatment.[59] Given the dire financial straits of petitioners who invoke the bankruptcy court's intervention, however, bankruptcy necessarily contemplates that debtors benefit from reorganization at the expense of creditors through refinancing or absolution of preexisting debts.[60] Section 365 of the Bankruptcy Code is one means by which the statutory scheme ensures Chapter 11 debtors remain financially viable post-bankruptcy.

Section 365 provides debtors with the ability, subject to the court's approval, to "assume or reject any executory contract or unexpired lease," excusing the parties from their remaining obligations thereunder.[61] Conversely, the Bankruptcy Code instructs that "[i]f a contract is not executory, it cannot be rejected and the parties remain obligated [to fulfill all promises not yet performed at the time of the petitioner's filing], notwithstanding the intervention of bankruptcy."[62]

Not every executory contract may be rejected. For example, the bankruptcy trustee may not assume executory contracts into the bankruptcy estate unless the trustee adequately assures the applicable creditor that any defaults on the contracts subject to assumption will be promptly cured.[63] Specifically, these assurances are limited to: (1) promising to perform nonmonetary obligations under an unexpired lease of real property;[64] (2) compensating a party other than the debtor for any actual pecuniary loss resulting from such default;[65] and (3) providing adequate assurances of future performance under such contract or lease.[66]

Granting the debtor this freedom to reject or assume executory contracts that meet certain conditions serves two purposes: (1) "[i]t relieves the debtor of burdensome future obligation while [the debtor] is trying to recover financially" . . . and (2) "it constitutes a breach of the contract which permits the other party to file a creditor's claim."[67] As noted earlier, this latter purpose preserves a non-debtor party's right to recover under a breach of contract claim as a general unsecured creditor. However, oftentimes the amount of repayment allowed is only cents on the dollar and only *after* the debtor satisfies its secured creditor claims. Considering the insolvency of the debtor, these features make this recourse highly undesirable to a midstream company that

52. *See Sabine Oil*, 547 B.R. at 74; *see also* Regan Loper, *Who Decides Whether Bankruptcy Jurisdiction Exists After Removal From State Court?* (Jan. 2017), http://www.burr.com/wp-content/uploads/2017/01/ALERT_Who-Decides-Whether-Bankruptcy-Jurisdiciton-Exists-After-Removal-from-State.pdf.
53. *See generally Sabine Oil*, 547 B.R. 66.
54. *See* Bankruptcy Reform Act of 1978 §§ 201(a), 402, 28 U.S.C. §§ 151, 1334(a) (2012); Regan Loper, *Who Decides Whether Bankruptcy Jurisdiction Exists After Removal From State Court?*, Burr Forman (Jan. 2017), http://www.burr.com/wp-content/uploads/2017/01/ALERT_Who-Decides-Whether-Bankruptcy-Jurisdiciton-Exists-After-Removal-from-State.pdf.
55. Rebecca McDowell, *Core & Non-Core Proceedings in Bankruptcy*, AllLaw.com, https://www.alllaw.com/articles/nolo/bankruptcy/core-non-core-proceedings.html (last visited Jan. 27, 2019). Core matters concern aspects such as recovery for fraudulent transfers, priority of liens, and the sale, use, or lease of bankruptcy estate property.
56. *See id.*
57. *See, e.g.*, *Sabine Oil*, 547 B.R. at 73.
58. *Id. See also* In re Network Access Sols., Corp., 330 B.R 67 (Bankr. D. Del. 2005) (ruling on motions to dismiss).
59. *See* Robert R. Graves, *The Interaction of the Bankruptcy Code and Environmental Laws: The Grit, the Grind, and the Grease*, 29 Willamette L. Rev. 297, 298 (1993).
60. *See* 11 U.S.C. § 365(a) (2012). *See also Chapter-11 Bankruptcy Basics*, U.S. Courts, http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics [https://perma.cc/NYC5-L8SG] (last visited July 7, 2018).
61. § 365(a).
62. In re Raymond, 129 B.R. 354, 357 (Bankr. S.D.N.Y. 1991).
63. 11 U.S.C. § 365 (b)(1)(A).
64. *Id.*
65. *Id.*
66. § 365(b)(1)(C).
67. In re Norquist, 43 B.R. 224, 225 (Bankr. E.D. Wash. 1984) (citing In re Jolly, 574 F.2d 349, 350 (6th Cir. 1978)).

has expended substantial capital in gathering and processing infrastructure.

Assumption into the bankruptcy estate of midstream agreements as executory contracts has major implications. Primarily, the debtor must assume the contract in its entirety. The implication of this is that, upon assumption, the bankruptcy estate becomes bound by the terms of the contract, and must perform its obligations thereunder as if no breach has occurred. Assumed executory contracts are classified as "administrative expenses" and are generally entitled to be repaid in full, with priority over most other secured and unsecured claims.[68] Hence, assuming midstream processing and gathering agreements as traditional executory contracts provides a more favorable resolution than outright rejection.

There is one major caveat to this categorization. Under section 363(f), a producer-debtor may elect to auction off its assets during the early stages of its Chapter 11 proceeding if it meets certain conditions.[69] The rationale for permitting the liquidation of assets under section 363 is to expedite Chapter 11 proceedings by quickly distributing sale proceeds to creditors, thereby alleviating a petitioner's debt burden.[70] Additionally, producer-debtors may propose a section 363 sale to avoid accruing administrative expenses paid to its midstream partner (i.e., the full contractual amount) as part of continuing its operations during bankruptcy.[71] This motivation proves especially strong where a producer faces default for its midstream agreements where penalties may be high. Given that natural gas infrastructure is not fungible, unless the producer "has an alternative midstream provider that it can turn to (both practically and legally), the debtor will need to use the [midstream] services under the contract that it is trying to reject."[72] However, given that the exclusive dealing feature of dedication provisions are often the key to securing a midstream service provider, finding an alternative midstream provider is unlikely.

C. Midstream Agreements as Real Covenants

Although the doctrine of real covenants is rooted in state common law, their creation and enforceability are fairly uniform. The scope of this Note limits its discussion to those common features.

Real covenants represent written promises to engage in or refrain from doing specific actions related to land.[73] While real covenants do not represent the grant of a property interest, they operate as contractual limitations or promises regarding another's use of their land.[74] The primary value of real covenants comes from their potential to "run with the land."[75] That is, subsequent owners of the land receiving the benefit of the promise (the "benefitted estate") may enforce the restriction against subsequent owners of the land upon which the restriction is imposed (the "burdened estate").[76] Because covenants are a law-based construct, enforcement allows current landowners to recover monetary damages in the event of a breach.[77]

To be enforceable, however, a party must show the court that both the benefit and the burden of the promise run with the land. To do so requires parallel analyses establishing similar attributes of the original promise. The two primary elements required to establish both the benefit and the burden require that: (1) the original parties to the covenant *intended* it to run with the land, and (2) the covenant "*touches and concerns*" the land (i.e., it must closely relate to the land or its use or enjoyment).[78] These elements generally form the centerpiece of real covenant litigation, though bespoke contractual language makes deciphering intent all the more enigmatic than it might be. Additionally, as discussed in detail below, assessing the degree to which a particular promise may be said to *touch and concern* the land—rather than the property owner individually—can become quite unclear where the covenant entails an affirmative promise to pay money to be used in connection with the land (such as homeowner's association fees).

Aside from these shared elements, the enforcing party must show that the burden runs with the land by establishing that a purchaser of the burdened estate: (1) had notice of the covenant at the time of purchase;[79] (2) is in vertical privity with its predecessor(s)-in-title; and (3) that the original covenanting parties were in horizontal privity.[80] To prove that the benefit runs with the land, the enforcing party must only show the additional element of vertical privity between itself and its predecessor(s)-in-title of the benefitted estate.[81] Because the element of touch and concern has been the source of dispute in *Sabine*, the remainder of this Note focuses on this aspect of real covenants.

68. *See, e.g.*, In re U.S. Metalsource Corp., 163 B.R. 260, 269 (Bankr. W.D. Pa. 1993).
69. § 363(f).
70. *See* Jessica Uziel, Comment, *Section 363(B) Restructuring Meets the Sound Business Purpose Test With Bite: An Opportunity to Rebalance the Competing Interests of Bankruptcy Law*, 159 U. Pa. L. Rev. 1189, 1190–96 (2011).
71. Patrick A. Jackson, *Do MVCs in Midstream Contracts Give Rise to Administrative-Expense Claims in Oil and Gas?*, 35 Am. Bankr. Inst. J. 26, 26 (2016).
72. *Id.*
73. Richard R. Powell & Michael Allan Wolf, 9 Powell on Real Property § 60.04 (Michael Allan Wolf ed., 2018).
74. *Id.*
75. *Id.*
76. Susan F. French, *Toward a Modern Law of Servitudes: Reweaving the Ancient Strands*, 55 S. Cal. L. Rev. 1261, 1268–69 (1982). .
77. Powell & Wolf, *supra* note 73.
78. Paula A. Franzese, *Out of Touch: The Diminished Viability of The Touch and Concern Requirement in the Law of Servitudes*, 21 Seton Hall L. Rev. 235, 239 (1991) (citing Spencer's Case, 77 Eng. Rep. 72 (Q.B. 1583)) (covenant concerning land use will not be enforceable against successors unless requisite intent is present and promise touches and concerns the land).
79. "Notice" refers to actual, inquiry, or constructive notice as recognized by the applicable jurisdiction's recording statutes. 9 Powell on Real Property § 60.04; In re Sabine Oil & Gas Corp., 547 B.R. 66, 87 (Bankr. S.D.N.Y. 2016).
80. The modern notion of "privity" refers to the parties' being in "horizontal privity of estate" that is, for a covenant to run with the land, the original covenanting parties must share a simultaneous existing interest in the ownership of the land, as exists between a landlord and tenant or grantor and grantee. With respect to the latter, most courts have adopted the legal fiction of "fleeting" horizontal privity, which exists only for the moment that the parties are executing a conveying instrument. A second legal fiction, "vertical privity" allows courts to meet a corollary privity requirement which arises when a non-covenanting party (usually a lessor or lessee) is seeking to enforce a covenant which his predecessor in interest created. French, *supra* note 76, at 1272. *See also* In re Sabine Oil & Gas Corp., 547 B.R. 66, 73 (Bankr. S.D.N.Y. 2016) (providing a modern example of this concept).
81. Powell & Wolf, *supra* note 73.

Because covenants that touch and concern the land may conceivably survive in perpetuity, the common law has largely limited the kinds of usage restrictions that survive the parties to a narrow field.[82] The common law has tried to limit the definition of covenants that touch and concern the land to those agreements that "relate to the occupation or enjoyment of land," as opposed to agreements that "relate to the collateral and personal obligation of the grantor and lessor."[83] Despite the facial intuitiveness of this distinction, courts have continued to face analytical challenges trying to apply this standard to covenants that require payment to the benefitted estate owner or require the burdened interest holder to perform acts on the burdened land, but have more readily recognized covenants imposing prohibitions on an owner's use of his burdened parcel.[84]

In the context of producer-debtor bankruptcy, interested parties have argued that various production and midstream contracts touch and concern that surface acreage encompassing the producer-debtor's facilities.[85] Such theories emphasize the fact that the producer's conveyance of a portion of its leasehold for the specific, enumerated purposes of constructing and operating a gas gathering system constitutes an affirmative covenant limiting the midstream service provider's right to use and enjoy the land freely.[86] This ostensibly burdens the midstream operator's estate in order to directly benefit the producer's estate by guaranteeing the producer has access to pipeline infrastructure and processing facilities necessary to bring its extracted gas to market.

Midstream operators have sought to prove the elements of intent and touch and concern by emphasizing those contractual clauses that appear to alter their legal relations with the land as promisors of the covenant (mainly, that the value in their leased land is diminished by the covenant by making it less alienable), as well as those of the producer-debtors, as promisees of the covenant (to the extent that the value of its land is improved by the affirmative promise to engage in services economically beneficial to it). However, in *Sabine*, the bankruptcy court rejected these arguments, finding that they failed to satisfy either of the two applicable tests under Texas law. The first test considers whether the covenant at issue "affected the nature, quality or value of the thing demised, independently of collateral circumstances, or if it affected a mode of enjoying it."[87] The second test looked at whether "the promisor's legal relations in respect of the land in question are lessened—his legal interest as owner rendered less valuable by the promise . . . [and] if the promisee's legal relations in respect to the land are increased—his legal interest as owner rendered more valuable by the promise."[88] The court caveated these tests by noting that "it is not enough that a covenant affect the value of the land, 'it must still affect the owner's interest in the property or its use in order to be a real covenant.'"[89] Ultimately, Judge Chapman found that the Nordheim Agreements failed both of these tests. Judge Chapman reasoned that because Texas law distinguishes minerals in the ground as real property and extracted minerals as personal property, the dedication covenants in the Nordheim Agreements concern only the mineral products *produced from* real property, thus affecting only Sabine's personal property rights.[90] While these rationales provide compelling bases for concluding that the contracting parties intended to create a covenant running with the land, producer-debtors have put forth arguments equally as persuasive.

D. Midstream Agreements as Executory Contracts

In response to arguments that dedication clauses satisfy the elements to qualify as a real covenant, producer-debtors have argued that these provisions operate only as executory contracts. Many of these arguments point out that midstream agreements lack specific provisions reciting the promisor's reserving its right to impose a lien on the gathering system, and, as such, do not touch and concern the land.[91] That is to say, the alienability of the property in dispute—a property law concept—remains unaffected.[92] Instead, debtors argue that "dedication covenants are triggered contractually."[93] The trigger, they argue, is a producer's 'produc[ing] and saving' its midstream counter-parts' processed hydrocarbons, rather than any change upon the use of the land at issue.[94] Debtors argue that such provisions manifest an agreement over the treatment of the only *the products themselves*, but not any real property.[95]

While natural gas-producing states like Texas distinguish the legal status of minerals in place[96] and minerals extracted, most states with fewer or underdeveloped shale plays do not.[97] Texas, for example, treats an oil and gas lease between the producer and the landowner as a transfer of title for the oil and gas in place, thereby creating a possessory interest in the land that cannot be lost through abandonment.[98] In contrast, Kansas treats oil and gas leases as creating a nonpossessory interest in the land by virtue of a *profit a prendre*, such that a producer is permitted to enter and use another's property as is reasonably necessary for the producer to extract

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82. *Id.*
83. 1 Herbert Tiffany, The Law of Real Property § 126 (3d ed. 2018).
84. Jon W. Bruce & James W. Ely, Jr., The Law of Easements & Licenses in Land § 1:29 (2018) (discussing affirmative real covenants); Franzese, *supra* note 78, at 236.
85. *See, e.g.*, Westland Oil Dev. Corp. v. Gulf Oil Corp., 637 S.W.2d 903 (Tex. 1982) (holding that the burden of an agreement to assign interests in oil and gas leases touched and concerned the land, as it affected the nature and decreased the value of the burdened estate).
86. *See* In re Sabine Oil & Gas Corp., 547 B.R. 66, 75 (Bankr. S.D.N.Y. 2016).
87. *Id.* at 80 (quoting El Paso Refinery, L.P. v. TRMI Holdings, Inc. (In re El Paso Refinery, L.P.), 302 F.3d 343, 356 (5th Cir. 2002)).
88. *Id.* (quoting Westland Oil Dev. Corp. v. Gulf Oil Corp., 637 S.W.2d 903, 911 (Tex. 1982)).
89. *Id.*
90. *Id.* at 77–78.
91. In re EnergyTec, Inc.,739 F.3d 215, 223 (5th Cir. 2013).
92. *See id.*
93. *Sabine Oil*, 547 B.R. at 78.
94. *Id.*
95. *Id.* at 79.
96. David E. Pierce, *Oil & Gas Rights Are a Collection of Easements*, 33 Energy & Min. L. Found. 9, 318 (2012).
97. *Id.*
98. *See, e.g.*, Stephens Cty. v. Mid-Kansas Oil & Gas Co., 254 S.W. 290, 293 (Tex. 1923).

oil and natural gas minerals in place.[99] Like an easement, Kansas property law allows *profit a prendres* concerning minerals in place to be abandoned by the holder of the dominant estate.[100] This state-to-state differentiation significantly impacts a court's interpretation of dedication clauses, as evidenced in cases like *Sabine Oil* (applying Texas law).

Another common argument debtors rely on is in reference to fee provisions paid to midstream operators, arguing that these fees are "triggered simply by the *flow* of gas through the pipeline," whereas gathering fees are triggered by the midstream operator's *receipt* of gas from the producer's facilities.[101] These debtors argue that because these gathering fees are triggered by the receipt of gas—a movable product—they are not directly tied to the promisor's (producer-debtor's) land, absent any other such language in the agreement.[102]

IV. Proposing a Statutory Solution: Amend Sections 365 and 101

This part explores possible solutions to the current treatment of dedication provisions in the bankruptcy context. The first section addresses the conflicting policy rationales underlying the Bankruptcy Code and the common law of real covenants. The second section proposes two statutory solutions as the easiest course of remedy, and discusses their feasibility in fostering uniformity of treatment across state, federal district, and bankruptcy courts. The third section addresses one recently proposed alternative solution; namely, employing technical principles of contract drafting to increase the interpretive clarity of the parties' intent upon judicial review. This Note responds to such a proposal, arguing that because it fails to provide any binding interpretative guidelines for the courts, it offers only a limited solution. After addressing these shortcomings, this Note concludes with a summary of the ideas discussed.

The following discussion recognizes that state law has traditionally governed the type of property interests created in dedication provisions. As such, the solutions proposed in this Note only offer a reconceptualization of real covenant law to accommodate the modern contracting challenges faced in the fossil fuel extraction industry. Further, these solutions address only those types of gas gathering agreements at issue in *Sabine*.

A. The Alienability Conflict

Taking into account the common property law principles across several jurisdictions and the "fresh start" policy underlying Bankruptcy Code's statutory scheme,[103] the conflict between these two sources of law becomes apparent. The Bankruptcy Code seeks to "[give] the honest but unfortunate debtor . . . a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt."[104] In contrast, the value of real covenants exists in their ability to promote economically efficient uses of land.[105] This efficiency emerges from a real covenant's ability to allocate certain user rights between separately held possessory estates.[106] This practice enhances land utility of land ownership because usage restrictions that run with the land afford owners of benefitted estates certainty in knowing that the utility of their parcel is protected from potential diminution resulting from the servient estate's breach.[107] This certainty, in turn, provides the security needed to encourage investments in fixtures and improvements upon the land—such as constructing and operating gas gathering and processing infrastructure.[108]

Hence, the purpose of the Bankruptcy Code and real covenants appear at odds to the extent that the latter is designed to bind future owners to enumerated uses of property, making it more difficult for owners of burdened estates to convey their interests. In contrast, Chapter 11 proceedings are designed to relieve the debtor of unsecured liabilities by granting him or her discharge through a section 363 bankruptcy auction.[109] As cases like *Sabine* show, these goals can subject those hybrid contracts containing production and acreage dedication provisions (representing both a service arrangement and a conveyance) to inconsistent judicial treatment. To resolve this issue, this Note proposes to abandon the bankruptcy courts' strict common law construction of real covenants as applied in *Sabine*. Instead, certain real covenant principles should be codified in the Bankruptcy Code in sections 365 and 101 to more easily embrace these commonly used hybrid contracts.

B. Proposed Amendment to Section 365

The principle that debtors may shed onerous contractual debt obligations to refinance their capital structure appears in section 365 of the Bankruptcy Code.[110] Section 365 provides that the debtor may reject certain prepetition executory contracts from the bankruptcy estate and achieve discharge of its obligations thereunder.[111] This section allows a debtor to use its best "business judgment"[112] to breach its contracts with

99. *See, e.g.*, Burden v. Gypsy Oil Co., 40 P.2d 463, 466 (Kan. 1935).
100. *Id.*
101. In re Sabine Oil & Gas Co., 547 B.R. 66, 79 (Bankr. S.D.N.Y. 2016).
102. *Id.*
103. Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934) (finding that a fundamental goal of federal bankruptcy law is to give a debtor a financial "fresh start" by releasing the debtor from burdensome debts). *See also* Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 Harv. L. Rev. 1393 (1985).
104. *Local Loan Co.*, 292 U.S. at 244.
105. Uriel Reichman, *Towards a Unified Concept of Servitudes*, 55 S. Cal. L. Rev. 1177, 1184 (1982).
106. *Id.*
107. *Id.*
108. *Id.*
109. *See* 11 U.S.C. §§ 1141(c)–(d) (2012) (permitting, upon the court's confirmation of the debtor's Chapter 11 reorganization plan, the discharge of the debtor's prior debts).
110. *See, e.g.*, In re At Home Corp., 392 F.3d 1064, 1072 (9th Cir. 2004) (holding that bankruptcy court has equitable authority to approve rejection of unexpired nonresidential leases); In re Ionosphere Clubs, Inc., 85 F.3d 992, 1000 (2d Cir. 1996) (recognizing the applicability of equitable estoppel principles where a debtor has assumed a contract into its bankruptcy estate).
111. *See* 11 U.S.C. § 365.
112. The "business judgment rule" is a judicially made rule reflecting the bankruptcy court's presumption that, in making business decisions, corporate leadership will make informed decisions in good faith and in honest belief that the chosen

unsecured creditors where the debtor reasonably believes that its obligations therein will be onerous or detrimental to its post-bankruptcy operational viability.[113] Thus, section 365 is a key mechanism to help the debtor avoid falling back into insolvency upon the close of the bankruptcy estate.[114]

While at first glance, section 365 appears applicable to bankruptcy cases involving midstream gathering agreements, the section lacks a provision addressing midstream agreements containing dedication provisions.[115] Despite this omission, bankruptcy and district courts have found, without much inquiry or in-depth analysis, that these provisions may be analyzed against section 365 as it is currently written.[116] However, this is misguided. Such an attempt by bankruptcy judges to "gap-fill" where the Bankruptcy Code is silent amounts to judicial overreach to the extent that it retrofits common law property principles into a statutory provision. Such a practice requires the courts to impute their own judgment onto a relief framework that Congress originally designed to ensure equitable resolutions through uniform application, regardless of the idiosyncrasies of state-formulated common law. While gap filling may be appropriate in cases where the statute at issue is newly enacted or passed after a partisan political contest, it is not appropriate for wholly formed remedial statutes such as the Bankruptcy Code.

As alluded to above, the physical and economic realities of constructing and operating natural-gas gathering systems—which are fixed to the land, not easily removed, and often remotely located—imputes a continuing interdependency between a midstream operator and producer-debtor post-bankruptcy. This interdependency exists regardless of whether the producer-debtor elects to maintain (by assumption into the bankruptcy estate) or sell its wellhead assets in a section 363 auction, because as a fugacious resource, gas cannot be stored or transported absent a closed, pressurized distribution system. The implication here is that bankruptcy proceedings shift the bargain originally struck by the parties. Midstream operators are not actually released from their commitment to collect and process wellhead gas because if they stop providing services, they forfeit their investment. At the same time, however, they are no longer fairly compensated, as bankruptcy demotes their priority status for repayment by the original debtor or as a purchaser at auction exercises its newfound leverage over a midstream operator by negotiating a new gathering deal on unfavorable terms for the operator.

Therefore, to ensure the continuing health of this relationship, it is necessary to amend section 365 to include provisions outlining an analytical test to determine the type of property interest created by dedication clauses. Such an amendment would provide much needed instruction and guidance for producers and midstream companies as they negotiate and draft agreements. Moreover, these changes would provide financial certainty to investors when assessing risks in financing a new drilling operation.

To mitigate these undesirable effects, this Note proposes adding a new paragraph to the Bankruptcy Code section 365. Currently, section 365 addresses executory contracts and unexpired leases and whether they may be assumed or rejected.[117] The new paragraph to section 365 would preserve the readability and cohesiveness of section 365 because it outlines similar limitations on how trustees determine assumption for other forms of prepetition contracts. As such, a new paragraph in this section is the most logical and appropriate placement. Further, as a means of reconciling the conflicting policy goals of the Bankruptcy Code and real covenant doctrine, below appears proposed language to be included in the new paragraph:

> (a) Notwithstanding any other provision of this section, the trustee may not reject any written contract to which the debtor is an original party and which contains the following provisions:
>
> (1) A dedication of all gaseous hydrocarbons extracted from all or a portion of the mineral acreage owned by, leased, by, or assigned to, the debtor to the undersigned counterparty named therein for purposes of temporary storage or processing in preparation for movement in commerce;
>
> (2) A promise by the undersigned counterparty accepting receipt of all gaseous hydrocarbons described in subsection (1) for purposes of benefitting the debtor's estate, and;
>
> (3) Dedication of Acreage
>
> i.dedicates surface acreage owned by, leased by, or assigned to, the debtor to the same unaffiliated entity described in subsection (1) for purposes of constructing or operating all fixtures necessary to perform the agreed upon storage and processing services.
>
> (b).For purposes of this Title, and notwithstanding any other applicable law, any contract containing the provisions described in subsections (1)–(3) above shall be defined as covenant running with the land.

As a general matter, and in keeping with the tradition of real property law, the proposed amendment to section 365 sets forth the elements that must be proven in order for a real covenant to run with the land. The proposed amendment codifies the two least contentious elements of real covenants: the "writing" requirement and the "notice" requirement. This has been achieved by simply adding language stipulating that only certain contracts—"written contracts" as opposed to oral or implied-in-fact contracts—may overcome this threshold requirement for creating a real property inter-

course of action was taken to promote the best interests of the company. *See, e.g.*, In re Bidermann Indus. U.S.A., Inc., 203 B.R. 547, 552 (Bankr. S.D.N.Y. 1997).

113. *See, e.g.*, In re Sabine Oil & Gas Co., 547 B.R. 66, 71 (Bankr. S.D.N.Y. 2016)

114. *See* Michelle Morgan Harner et al., *Debtors Beware: The Expanding Universe of Non-Assumable/Non-Assignable Contracts in Bankruptcy*, 13 Am. Bankr. Inst. L. Rev. 187, 193 (2005).

115. *See* 11 U.S.C. § 365.

116. *See, e.g.*, *Sabine Oil*, 547 B.R. at 71–72.

117. *See* 11 U.S.C. § 365(c).

est that would be recognized by the bankruptcy courts. This language may seem unnecessary given that agreements as complex, lengthy, and involving monetary amounts as large as those contemplated in gas gathering agreements necessarily must be reduced to a writing in order to be implemented; however, including this language serves to avoid potential disputes over oral modifications to the contract, which some states still treat as binding.[118] Additionally, by requiring that the debtor be "an original party," bankruptcy courts are better equipped to overcome issues raised under state law concerning the parties' intent to create a covenant.

Together, these provisions would function as threshold prerequisites for midstream operators to establish their right to enforce the covenant. In drafting these two requirements with unconditioned and unadorned language, the Bankruptcy Code would comport with the widely established precedent of state property law while continuing to afford successive midstream companies (the burdened estate owners) the same bona fide purchaser protections afforded other commercial and residential property purchasers and lessees. This would allow flexibility across the courts in different jurisdictions by allowing the bankruptcy court to apply state law principles to determine whether a particular written notation (hand-written or electronic, or signed by an owner's agent) has met the "writing" and "notice" requirements so as to impute liability on the burdened estate owner when he or she is considered statutorily "informed" of the restrictive covenant.

The proposed amendment to section 365 should also include a provision designed to accommodate the nuanced differences that exist across state-made real covenant law. This provision should allow for flexibility in the courts' analysis of the touch and concern element necessary in proving the existence of a covenant running with the land. The proposed provisions each serve to capture the common law's touch and concern element by narrowing in certain physical and functional attributes that memorialize the distinguishing features of a gas gathering facility. By including the phrase "accepting receipt of all hydrocarbons described in subsection (1)," the Bankruptcy Code would recognize midstream creditors' real property interest by their common functional attributes. Additionally, by including the phrase "for purposes of benefitting the debtor's estate," the Bankruptcy Code would retain the common law's distinction between a burden that runs with the burdened estate and a benefit that runs with the benefitted estate. This is true because, when construed together with its preceding provision, provision (2), the bankruptcy courts would be able to recognize that the debtor's delivery of hydrocarbons confers a benefit upon the debtor's estate by virtue of being alleviated of the hydrocarbons at issue, while leaving the undersigned counterparty's (the midstream operator) estate with the responsibility of storing and processing said materials. Finally, the third provision ensures that the types of situations in which the first two provisions apply remain narrowly tailored. This is because the third provision contemplates the existence of an infrastructure system, such as a midstream pipeline system built by a midstream operator for purposes of serving the benefitted estate owner. This limitation is necessary because it ensures that midstream operators that have invested their resources into building such a system remain the named party entitled to the benefits of section 365's mandatory assumption provisions.

Further, this Note recommends that the proposed amendment to section 365 take the opportunity to dispense with the "horizontal privity" element of the real covenant analysis by including a statutory amendment as a means of minimizing the discrepancy that currently exists across state jurisdictions. Likewise, the amendment should reconcile the "vertical privity" element of real covenants by setting forth a uniform statutory standard. Adding statutory amendments including language similar to the provisions offered above would serve as a proper starting point from which Congress can reconceptualize the common law's real covenant doctrine as means of resolving many of the current disputes between producers and their midstream creditors.

C. Proposed Amendment to Section 101

In addition to amending section 365, Congress should amend the Bankruptcy Code to unambiguously define the term "executory contract" where no definition currently exists.[119] The codified definition should appear within section 101 as the new subsection eighteen. This would displace the following subsections, causing the definition of "family farmer" to appear as the new subsection nineteen, the definition of "family farmer with regular annual income" to appear as the new subsection twenty, and so forth for all of the remaining subsequent definitions. The proposed statutory language should incorporate the commonly accepted definition of "executory contract." Such a definition could appear as follows:

> (17) The term "executory contract" means—
>
> > (A) a contract under which the obligation of both the debtor and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach. [120]

This definition should be added to the "general definitions" provisions of section 101 of the Bankruptcy Code—rather than to section 365—because this definition is general enough to be of functional use to bankruptcy proceedings well beyond those implicating natural gas gathering agreements.

Moreover, adding an express definition under section 101[121] would allow midstream creditors to deduce the legal characterization of their processing and gathering agreements

118. *See, e.g.*, Turner v. NJN Cotton Co., 485 S.W.3d 513, 520–21 (Tex. App. 2015); Thornton v. Dobbs, 355 S.W.3d 312, 317 (Tex. App. 2011).

119. *See* 11 U.S.C. § 365.

120. In re Raymond, 129 B.R. 354, 354 (Bankr. S.D.N.Y. 1991).

121. 11 U.S.C. § 101.

by process of elimination. By offering a definition for "executory contract," bankruptcy judges may confidently disqualify any midstream processing and gathering agreements that fail to meet each of the definition's explicit criterion from the category of "executory contracts." Applying deductive reasoning to the plain language of the amendment necessitates the conclusion that all contracts must fall into one of two categories: "executory contracts" and "non-executory contracts." This latter category arises from the fact that all contracts which fail one or more of the statutorily defined criterion for "executory contracts" would have to be placed into an alternative category defined only by the negation of one or more distinguishing elements of "executory contracts." Hence, the "non-executory contract" category would function as a catchall for agreements for payment or services. This could feasibly range from commonplace checks and money orders (stipulating the drawer's promise to pay the payee) to formal conveyance instruments (deeds of trust, wills, etc.). So, if "covenants running with the land" fail to meet the definition of an "executory contract" because the covenant does not denote an "obligation of both the bankrupt [debtor] and the other party to the contract" (which are at the time of the debtor's filing for bankruptcy, yet to be performed), then deductive logic necessitates concluding that covenants "running with the land" fall within the "non-executory contracts" category and must be included in the bankruptcy estate. This conclusion stands regardless of whether or not the traditional elements of a real covenant are satisfied in the writing and nature of "dedication of production" provisions.

Such a definition would obviate the need for courts to analyze the public policy issues associated with enforcing affirmative covenants and potentially further complicate the already entangled jurisprudence of servitudes. In fact, the amendment to section 101 may provide the most direct and painless means by which to resolve the discrepancy among district and bankruptcy courts' treatment of "dedication of production" provisions. It allows Congress to provide uniformity while avoiding the challenge of having to reconcile states' promulgations of the "touch and concern," "horizontal," and "vertical" privity elements of real covenants.

D. Potential Counterarguments to Proposed Amendments

Although other legal scholars have proffered novel principles of legal drafting in an attempt to close the "dedication of production" loophole in section 365, such proposals cannot insulate midstream companies from the whims of influential bankruptcy courts like the Southern District of New York. These scholars have offered systematic ways to ensure the creation of a real covenant by outlining the same parameters as mentioned in the preceding sections. While tailoring their solution in the least intrusive manner possible is a valid strategy, it offers no more security to midstream companies than their prior practice of employing precise language to communicate their intent to create a real covenant. Rather, as cases like *Sabine* suggest, the ultimate authority in these determinations remains with the courts, which are currently free to apply their own interpretations of common law property principles to the facts of a given case without having to answer to any statutory guideposts. This poses too much of a financial risk for midstream company investors, and will detract from investing incentives.

In contrast, providing uniformity of interpretation across bankruptcy and district courts alike through federal statutory amendments ensures the financial protection necessary to lure midstream companies out of the shell shock suffered in the wake of *Sabine*. In replacing the "business judgment" standard of rejection with an added definition and an evaluative standard for determining the existence of a "covenant running with the land," parties are afforded additional clarity of the legal consequences of their agreements. Such added clarity through statute would undercut the bases for the parties to litigate in the future. This, in turn, could help lower transaction costs because the parties would not have to account for the particular litigation risks associated with these disputes.

V. Conclusion

The 2014 downturn in fossil fuel prices led a multitude of domestic energy producers to file petitions for Chapter 11 bankruptcy, and has caused many more courts to face the issue of how to interpret "dedication of production" provisions in midstream gathering and processing agreements. Even with established case law recognizing the enforceability of covenants "running with the land" in commercial leases, bankruptcy and general jurisdiction courts alike have failed to account for the unique challenges that "dedication of production" provisions present. Recent decisions like *Sabine* have claimed that these provisions do not invoke real property interests. Because of this, midstream companies currently have no recourse to ensure that their multi-million investments are protected from the risk of their producer counterparts from abruptly stopping payment as a result of rejecting their contractual obligations under section 365.

Although the bankruptcy courts hold that the authority to sign off on a debtor-producer's exercise of its "reasonable business judgment" in rejecting midstream gathering and processing agreements as executory contracts under section 365, Congress retains the discretion to expand or contract existing common law rationales and principles to resolve this modern problem and promote the underlying policy goals of bankruptcy's statutory regime. Congress should consider the modernization of the doctrine of real covenants as it has evolved in the context of commercial operational covenants, which move materials collected from a single point-source (the wellhead) through a closed transport system to reach an end-user (the downstream supplier).

With the industry's growth, there are well-founded concerns that producers will adopt predatory business practices at the expense of capital-strapped midstream companies and enjoy a windfall through a loophole in the Bankruptcy Code, the need for uniform resolution on the real property implications of "dedications of production" is more pertinent than ever. By amending section 101 or section 365, these judicial interpretations of "dedication of production" provisions will provide much needed stability to private investors and bankruptcy courts alike. These proposed amendments will safeguard these massive investments without losing the equitable remedy that section 365 provides in permitting a debtor to reject onerous agreements because these amendments will be narrowly drafted to apply only in cases where the midstream agreement at issue "dedicates production."