Vinson&Elkins

Energy Series

Distressed Upstream Oil and Gas Transactions

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Meet the Speakers

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Bryan Loocke is an accomplished transactional lawyer who represents public and private clients in a variety of domestic upstream and midstream oil and gas transactions.

Over the course of nearly two decades he has been involved in a wide range of transactions including drilling participation agreements, farmouts, operating agreements, gathering and transportation agreements, rig agreements, production payments, preferred equity investments and traditional and mezzanine financings.

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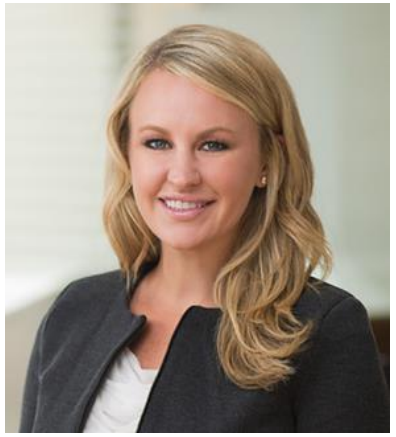

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Agenda

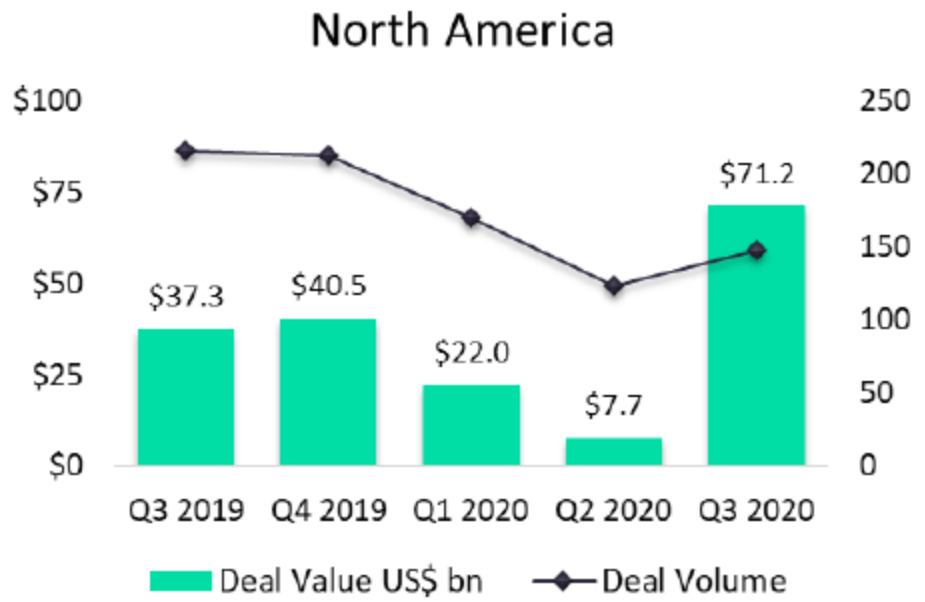
1. Recent Market and Bankruptcy Trends
2. Pre-Bankruptcy Transactions
3. Bankruptcy and 363 Sales Processes
4. Midstream Contracts in Bankruptcy Processes

Recent Market and Bankruptcy Trends

Recent Oil and Gas M&A Trends

- M&A deal values in the oil and gas industry in 2020 were US$182.5bn at the end of Q3, down by 45% versus the first three quarters of 2019.
- Deal volume improved in Q3 compared with Q2 (417 vs. 323).
- The majority of M&A deals in Q1-Q3 2020 were in the upstream sector with US$29.4bn in total value, compared with US$119.4bn over the same period of 2019, a fall of 75.4%.

M&A Activity in Oil and Gas by Value and Volume

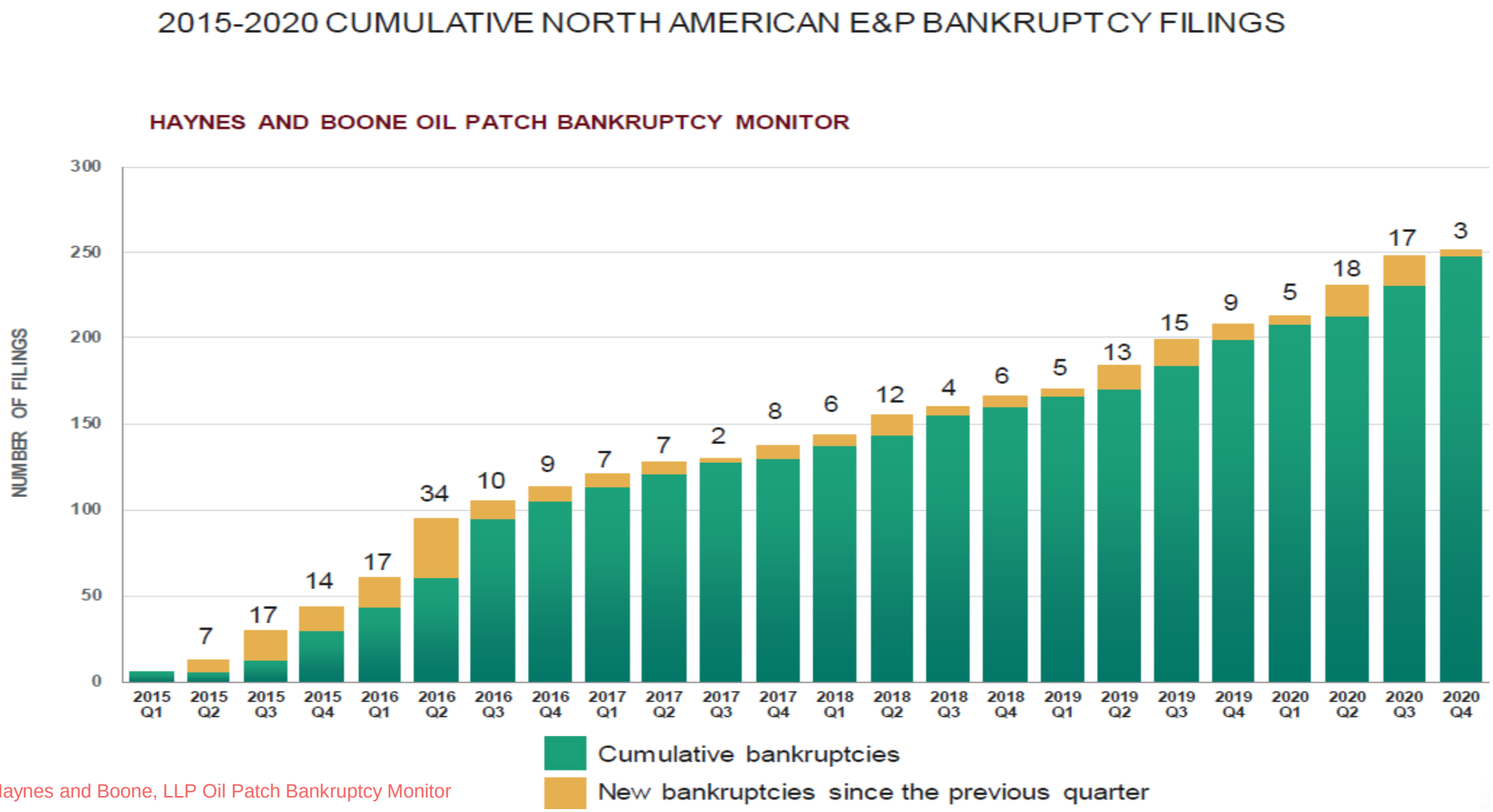


Source: GlobalData Deals database

Factors Contributing to the Decrease in M&A Activity

- Triggered or accelerated traditional energy bankruptcies
- Tightened traditional energy capital markets and lending markets
- Delays in sales processes
- Widening of bid/ask spreads
- Investments have less “room for error” due to broader economic uncertainty
- Commodity price fluctuations
- Regulation changes and uncertainty
- Consolidations (at the company and basin level)

Distressed Market Conditions Resulting in an Increase in Bankruptcies



Source: Haynes and Boone, LLP Oil Patch Bankruptcy Monitor

Distressed Market Conditions Resulting in an Increase in Bankruptcies

LIST OF NORTH AMERICAN OIL AND GAS PRODUCER BANKRUPTCIES*

2020 BANKRUPTCIES, January – August

FILING DATE	COURT	CASE NUMBER	DEBTOR	SECURED	UNSECURED	TOTAL
01/14/2020	C.D. Cal.	20-10143	BRIDGEMARK CORPORATION	$ 199,879	$ 53,463,571	$ 53,663,450
01/27/2020	D. Del.	20-10158	SOUTHLAND ROYALTY COMPANY LLC	$ 561,972,109	$ 63,075,091	$ 625,047,200
02/17/2020	W.D. Tex.	20-50369	DALF ENERGY, LLC	$ 23,482	$ 1,194,791	$ 1,218,273
03/23/2020	S.D. Tex.	20-31884	SHERIDAN HOLDING COMPANY I, LLC*~	$ 616,100,000	$ 2,385,147	$ 618,485,147
03/24/2020	S.D. Tex.	20-31920	ECHO ENERGY PARTNERS I, LLC	$ 80,448,980	$ 10,811,536	$ 91,260,516
04/01/2020	S.D. Tex.	20-32021	WHITING PETROLEUM COMPANY~	$ 1,071,966,400	$ 2,494,849,093	$ 3,566,815,493
04/01/2020	D. Colo.	20-12377	SKLAR EXPLORATION COMPANY, LLC~	$ 22,859,666	$ 18,141,322	$ 41,000,988
04/06/2020	S.D. Miss.	20-01244	AMAZING ENERGY LLC~	$ 8,481,170	$ 5,007,939	$ 13,489,109
04/09/2020	E.D. Cal.	20-11367	TEMBLOR PETROLEUM COMPANY, LLC	$ -	$ 12,198,912	$ 12,198,912
04/15/2020	N.D. Tex.	20-41455	YUMA ENERGY, INC.~	$ 2,250,000	$ 41,128,602	$ 43,378,602
04/30/2020	S.D. Tex.	20-32391	BUZZARDS BENCH, LLC*~	$ 15,560,455	$ 7,545,741	$ 23,106,196
05/06/2020	S.D. Tex.	20-32487	VICTERRA ENERGY HOLDING CO., LLC~	$ 15,243,156	$ 3,750,650	$ 18,993,806
05/11/2020	S.D. Tex.	20-32582	FREEDOM OIL & GAS, INC.~	$ 49,113,463	$ 515,882	$ 49,629,345
05/14/2020	N.D. Tex.	20-41754	NEW EMERALD ENERGY, LLC	$ 38,244,956	$ -	$ 38,244,956
05/14/2020	S.D. Tex.	20-32631	ULTRA PETROLEUM CORP.^^ ~	$ 24,091,520	$ 5,532,056,552	$ 5,556,148,072
05/15/2020	S.D. Tex.	20-32656	GAVILAN RESOURCES, LLC~	$ 552,276,460	$ 568,527,805	$ 1,120,804,265
05/22/2020	S.D. Tex.	20-32740	UNIT CORPORATION~	$ 139,000,000	$ 4,669,182,228	$ 4,808,182,228
05/31/2020	D. Del.	20-11441	TEMPLAR ENERGY LLC~*	$ 456,000,000	$ 9,700,000	$ 465,700,000
06/14/2020	D. Del.	20-11548	EXTRACTION OIL & GAS, INC.~	$ 604,199,296	$ 1,918,373,865	$ 2,522,573,161
06/17/2020	D. Del.	20-11593	CHISHOLM OIL AND GAS OPERATING, LLC~	$ 516,827,035	$ 43,176,450	$ 560,003,485
06/25/2020	S.D. Tex.	20-33193	SABLE PERMIAN RESOURCES, LLC~	$ 1,321,262,936	$ 113,033,749	$ 1,434,296,685
06/28/2020	S.D. Tex.	20-33233	CHESAPEAKE ENERGY CORPORATION~ * ^^^	$ 5,759,133,190	$ 6,040,866,810	$ 11,800,000,000
06/28/2020	S.D. Tex.	20-33274	LILIS ENERGY, INC.~	$ 227,573,463	$ 352,302,871	$ 579,876,334
07/07/2020	W.D. Tex.	20-10768	MEXTEX OPERATING COMPANY	$ -	$ 7,434,527	$ 7,434,527
07/11/2020	N.D. Ok.	20-11144	BULLSEYE ENERGY, LLC	$ -	$ 193,743	$ 193,743
07/15/2020	S.D. Tex.	20-33568	CALIFORNIA RESOURCES CORPORATION~	$ 4,991,010,656	$ 1,294,812,849	$ 6,285,823,505
07/16/2020	S.D. Tex.	20-33605	BRUIN E&P PARTNERS, LLC~ *	$ 510,000,000	$ 567,000,000	$ 1,077,000,000
07/19/2020	E.D. Mich.	20-47870	COLUMBUS OIL & GAS, LLC^^	$ 6,773,128	$ 19,215,531	$ 25,988,659
07/26/2020	S.D. Tex.	20-33697	BRAHMAN RESOURCE PARTNERS, LLC~*	$ 10,098,483	$ 3,602,672	$ 13,701,155
07/26/2020	S.D. Tex.	20-33695	ROSEHILL RESOURCES INC.*	$ 338,200,000	$ 24,500,000	$ 362,700,000
07/30/2020	S.D. Tex.	20-33801	DENBURY RESOURCES INC.~	$ 2,000,000,000	$ 500,000,000	$ 2,500,000,000
07/31/2020	D. Wy.	20-20377	SUMMIT GAS RESOURCES, INC.	$ 609,877	$ 5,629,856	$ 6,239,733
08/03/2020	S.D. Tex.	20-33948	FIELDWOOD ENERGY INC. ^^ ~ *	$ 1,799,200,000	$ 160,000,000	$ 1,959,200,000
08/12/2020	S.D. Tex.	20-34037	REMORA PETROLEUM, L.P. ~ *	$ 64,755,208	$ 8,753,643	$ 73,508,851
08/16/2020	D. Del.	20-11947	CHAPARRAL ENERGY, INC.^^ ~	$ 581,633,528	$ 2,961,255,107	$ 3,542,888,635
08/20/2020	S.D. Tex.	20-34215	ARENA ENERGY, LP ~ *	$ 1,068,650,000	$ 3,507,800	$ 1,072,157,800

*Debt estimated per First Day Declarations or other pleadings; schedules not yet available.
~Lead case – estimate includes affiliate(s); debt may be duplicative to a certain extent.
^^Second filing.
^^^Chesapeake filed on 8/21/2020 its schedules with a total of over $95B in debt, most of which is intercompany loans and therefore not included.
(As of October 31, 2020)

Source: Haynes and Boone, LLP Oil Patch Bankruptcy Monitor

Distressed Market Conditions Resulting in an Increase in Bankruptcies

LIST OF NORTH AMERICAN OIL AND GAS PRODUCER BANKRUPTCIES*

2020 BANKRUPTCIES, September – October

FILING DATE	COURT	CASE NUMBER	DEBTOR	SECURED	UNSECURED	TOTAL
09/01/2020	N.D. Tex	20-42794	BAINBRIDGE UINTA, LLC~	$ 61,700,000	$ 1,384,118	$ 63,084,118
09/02/2020	D. Del.	20-12065	URSA PICEANCE HOLDINGS LLC~	$ 283,208,949	$ 19,997,038	$ 303,205,987
09/29/2020	W.D. Tex.	20-70117	REATA PROPERTIES, LP**	$ 128,500,000	$ -	$ 128,500,000
09/30/2020	S.D. Tex.	20-34771	OASIS PETROLEUM INC.*	$ 438,000,000	$ 1,827,000,000	$ 2,265,000,000
10/12/2020	S.D. Tex.	20-34966	MD AMERICA ENERGY, LLC ~	$ 117,849,544	$ 17,070,353	$ 134,919,897
10/13/2020	W.D. Tex.	20-51742	FINGER OIL & GAS, INC.	$ -	$ 624,756	$ 624,756
10/14/2020	W.D. Ok.	20-13383	ONPOINT OIL & GAS, LLC	$ 2,631,374	$ 209,082	$ 2,840,456
TOTAL 2015				$ 9,428,934,657	$ 7,948,644,822	$ 17,377,579,479
TOTAL 2016				$ 20,381,058,466	$ 36,458,841,062	$ 56,839,899,528
TOTAL 2017				$ 4,028,066,757	$ 4,515,455,884	$ 8,543,522,641
TOTAL 2018				$ 8,467,115,402	$ 4,688,644,031	$ 13,155,759,433
TOTAL 2019				$ 11,654,278,568	$ 14,113,409,087	$ 25,767,687,655
2020 YTD				$ 24,485,648,363	$ 29,383,479,682	$ 53,869,128,045
TOTAL 2015-2020				$ 78,445,102,213	$ 97,108,474,568	$ 175,553,576,781

*Debt estimated per First Day Declarations or other pleadings; schedules not yet available.
~Lead case – estimate includes affiliate(s); debt may be duplicative to a certain extent.
^^Second filing.
^^^Chesapeake filed on 8/21/2020 its schedules with a total of over $95B in debt, most of which is intercompany loans and therefore not included.
(As of October 31, 2020)

Source: Haynes and Boone, LLP Oil Patch Bankruptcy Monitor

Pre-Bankruptcy Transactions

Alternative Structures – Pre-Bankruptcy Transactions

- Benefits
  - Faster than bankruptcy sales
  - Parties directly negotiate closing risk (conditions to closing) and terms of definitive documents
  - Customary allocation of liabilities and pre- and post-effective time expenses
  - General diligence period and adjustment for title and environmental defects, casualty losses, etc.
  - No court approval required
- Risks/Downside
  - Fraudulent Transfer Risks / Avoidable Preferences
  - Purchaser is unable to bind non-consenting creditors who do not consent to the terms of the purchase
  - Acquisition is not “free and clear” of existing liens, claims and encumbrances
  - PSA Considerations
    - If Seller files for bankruptcy after signing but before closing, Buyer may be stuck with a “hanging” PSA that Seller can reject as an executory contract. Can be mitigated by providing for an absolute and automatic drop-dead date termination in the PSA.
    - If Seller files for bankruptcy after closing, Buyer may be left with unenforceable indemnities and no post-closing recourse; prepetition unsecured claims against debtor Seller.

Pre-Bankruptcy Transactions

- Pre-bankruptcy transactions may be avoided as a “fraudulent transfer” or “fraudulent conveyance”
- Federal and State Look-Back Period
  - Federal look-back period: 2 years
  - State look-back period: usually longer (TX: 4 years)
- If transaction is determined to be a fraudulent transfer:
  - Trustee has the power to (1) recover assets from the Buyer or (2) recover the full value of the assets from the Buyer (e.g., the value of the assets at the time of transfer less than what was actually paid)
  - Remedies of Buyer
    - “Good faith” Buyers are entitled to a lien on the assets to secure the value of any improvements made by the Buyer after the initial closing
    - If debtor in possession or Trustee recovers the assets, Buyer has a claim for damages/recovery of purchase price – typically a general unsecured claim
    - If PSA has not closed, Buyer can seek return of deposit

Note: Even though assets may be returned to the Debtor in possession or Trustee, Buyer may remain liable for unavoidable obligations (such as plugging and abandonment, credit support, environmental obligations, etc.) by virtue of closing the avoided transaction and/or entering the chain of title

Pre-Bankruptcy Transactions (con't)

- Actual Fraud: Transfers *"with actual intent to hinder, delay, or defraud" a* creditor
- Constructive Fraud: Debtor received less than a *"reasonably equivalent value"* and debtor:
  - was insolvent at the time, or as a result, of the transfer;
  - made the transfer, or incurred such obligation, to or for the benefit of an insider, under an employment contract and not in the ordinary course of business;
  - was engaged, or was about to engage, in business or a transaction for which any property remaining with debtor was "unreasonably small capital" (this prong is applicable to TX but not other states); or
  - intended to, or believed that debtor would, incur debts that would be beyond debtor's ability to pay such debts as they mature (this prong is applicable in TX but not other states).
- Defense to Constructive Fraud: Transferee acted in "good faith" and the transfer was "for reasonably equivalent value"

Pre-Bankruptcy Transactions (con't)

- PSA considerations
  - No deposit or deposit in third party escrow account
  - Hold backs, escrows, parent guaranties or other credit support for indemnities and PSA obligations. This would likely take the form of a deferment or escrow of a portion of the Purchase Price after Closing
  - Draft to guard against Seller's ability to reject or accept specific agreements (e.g., include key provisions all in one agreement)

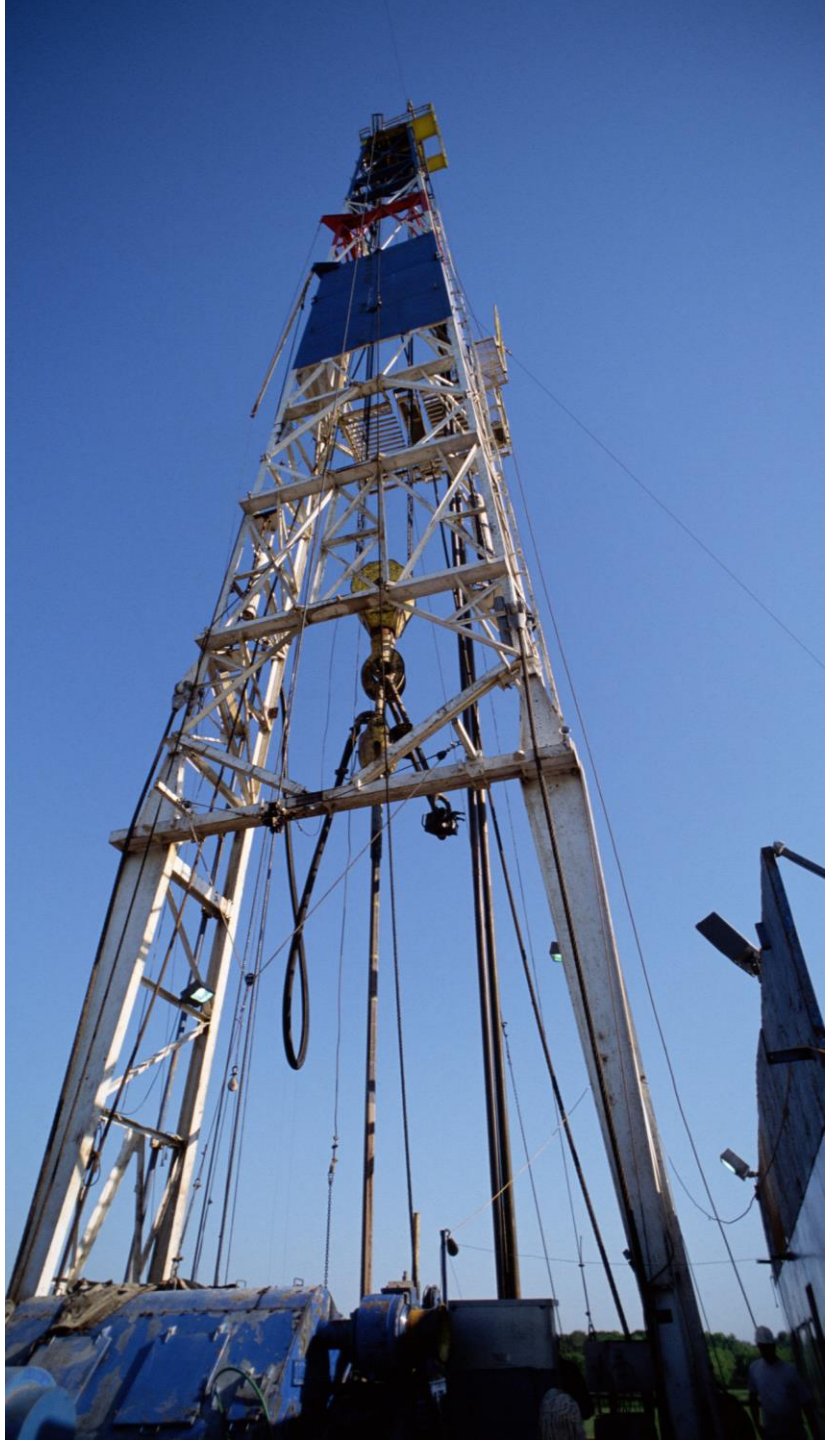
Pre-Bankruptcy Transactions – Acquisition in Lieu of Foreclosure by Lender

- Similar considerations as pre-bankruptcy transactions with other third parties
- Post-closing considerations
  - Management Services Agreement
    - Services
    - Fees
    - Limitations and control over operations
    - Allocation of risk and responsibilities
    - Term and termination provisions

Bankruptcy and 363 Sales Processes

Bankruptcy Process

- Types of Bankruptcy Filings
  - Chapter 7 (liquidation)
  - Chapter 11 (reorganization)
- Summary of a Chapter 11 Case
  - Case commencement (voluntary vs. involuntary)
  - First day hearings (ensure smooth transition into bankruptcy case)
  - Automatic stay (federal injunction)
  - DIP financing/cash collateral (funding the case)
  - Goal: implement a transaction (typically through either a chapter 11 plan or a sale of substantially all assets)



Bankruptcy Process

- Certain key issues in a Chapter 11 Case
  - Executory contracts and unexpired leases (JOAs, leases, other)
  - Treatment of prepetition claims (vendors, employees)
  - Preferences (unwinding preferential transfers)
  - Fraudulent transfers (actual vs. constructive, value issues)
  - Lien priority issues (collateral gaps, M&M lienholders)
  - Valuation (i.e. who is entitled to a recovery)
  - Feasibility (i.e. how much debt can a reorganized company sustain)

363 Sale Transaction Overview

- Section 363 of the Bankruptcy Code permits debtors in bankruptcy to sell all or a portion of their assets, subject to certain restrictions
- If a debtor pursues an asset sale outside the ordinary course of business—such as a sale of all or substantially all assets—notice and a hearing before the court is required
  - The court must approve the transaction documents, including bidding procedures, the PSA, and the sale order
  - Key stakeholders and other parties in interest may object
- In a 363 sale, the buyer acquires assets "free and clear" of liens and claims (potentially including certain successor liabilities)
  - No fraudulent transfer risk
  - Generally, liabilities that may be subject to indemnities in an out of court sale can be discharged or otherwise left with the debtor's estate
- The debtor may enter into a PSA with a "stalking horse" bidder, subject to certain negotiated and court-approved protections, such as a break-up fee and/or expense reimbursement
- Secured creditors have the right to "credit bid" up to the face amount of their debt under the Bankruptcy Code

Unique Aspects of Bankruptcy Process

- Treatment of executory contracts
  - Debtors may assume and assign certain contracts to buyer
  - Cure costs must be cured as part of any assumption
  - Dealing with pref rights / “deemed” consent
- Auction process
  - Marketing process to find bidders at the auction
  - Determination of qualified offers and court approved bidding procedures to govern process
  - Auction conducted
  - Winner signs up winning form of PSA with debtor, court approves transaction
  - Closing and the backup bidder(s)
- “Free and clear”
  - Interaction with applicable state law, federal law
  - Oil and gas leases and royalty obligations under state law

PSA Terms Unique to 363 Sale Processes

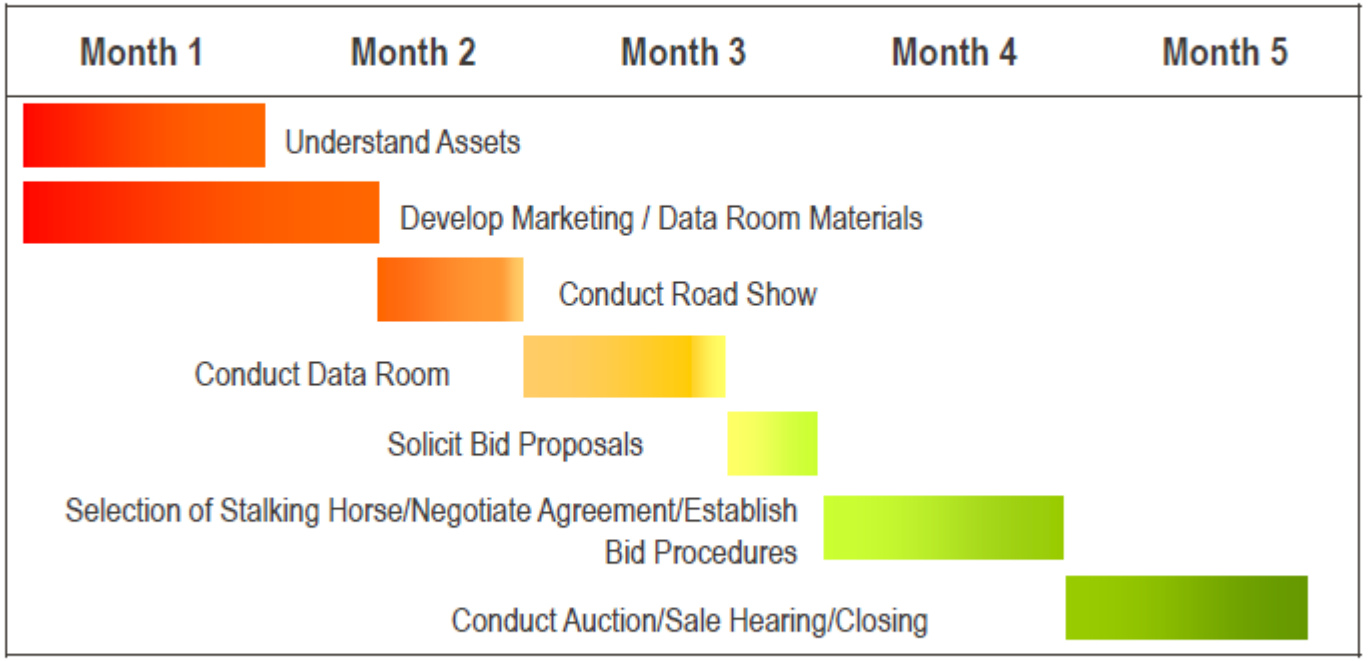
- Purchase Price and Purchase Price Adjustments
  - Executory contract cure amounts
  - Executory contract future performance assumption
  - True-up adjustments (cut-off date for revenue and cost adjustments)
- Assumed Contracts
  - Buyer's election to assume or reject executory contracts
  - Seller's desire to designate certain "deemed" assumed contracts
  - Contracts that purport to contain covenants running with the land
- Assumption and Retention of Liabilities; Indemnification
  - Buyer's assumption of post-closing liabilities and certain pre-closing remediation and decommissioning obligations
  - Seller's retention of pre-closing liabilities and existing litigations
  - Survival of Seller's indemnification obligations and post-closing covenants
- Termination provisions
  - Back-up bidder and credit bid protection

Strategic Points for a 363 Sale Buyer

- Due diligence is uniquely beneficial in bankruptcy sales
  - To buyer because recourse against an insolvent and often short-lived debtor is of little value
  - To seller (open and full disclosure) because better buyer intelligence leads to lower risk and thus higher auction bids in a short time frame
- Lowball bidder may see opportunity to obtain assets cheaper in a liquidation, but the corollary is that bidder must recognize that, in effect, the liquidation value of the assets puts a floor under the potential bids
- Closing certainty carries more strategic weight in bankruptcy than in conventional sales, as the debtor may not survive a failed bankruptcy auction process
- Cash is king
- Bankruptcy Court Goal: highest and best offer for assets being sold

Bankruptcy Processes – Timing

Timeline – § 363 Asset Sale



- The timeline is driven by *upside documentation* and creation and/or compilation of data room information The front-end preparation phase is crucial to generating maximum value, as well as preserving that amount during the due diligence phase

General Observations of Bankruptcy and 363 Sale Processes – Calendar Year 2020

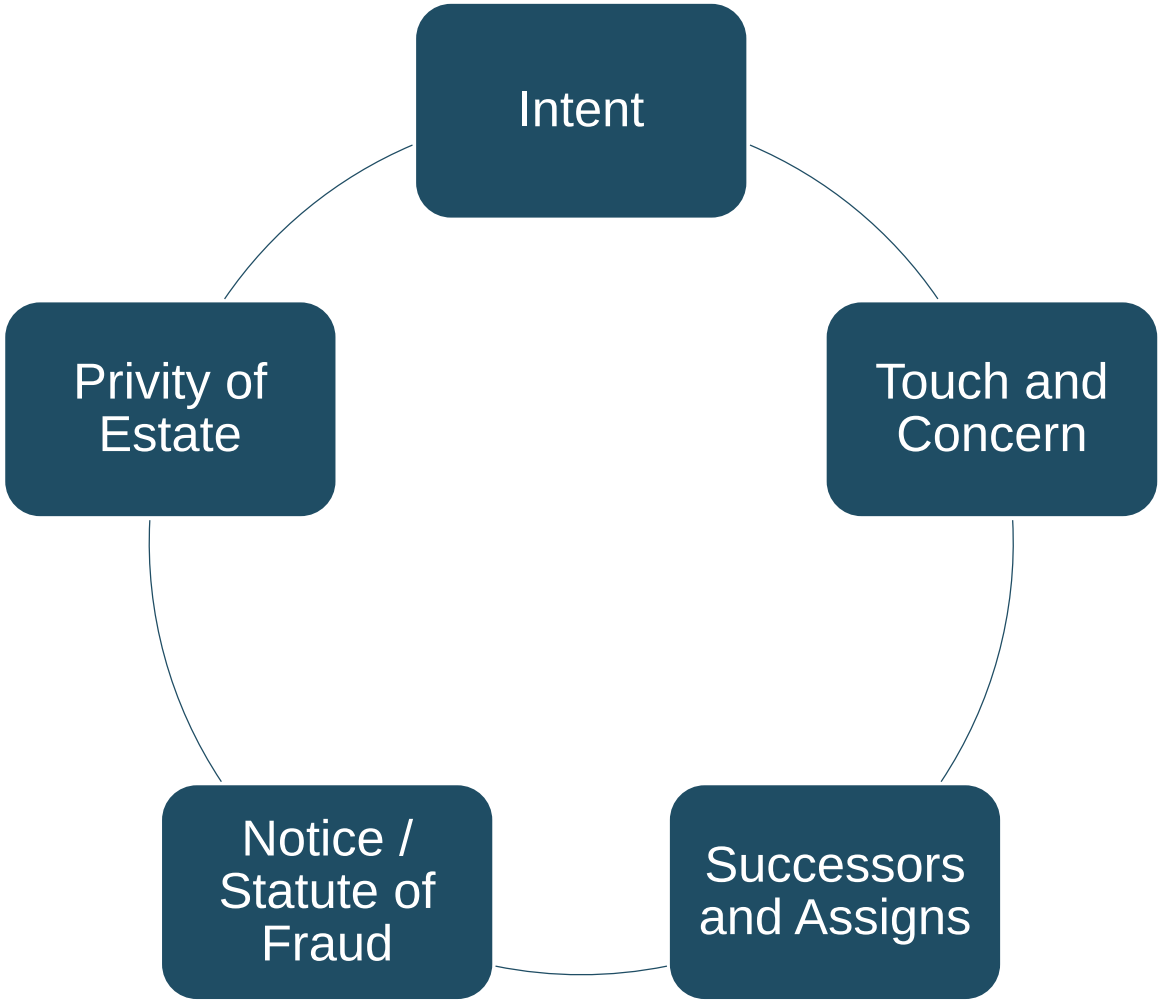
- Certainty in an uncertain world
- Driver for negotiations with junior creditors
- Clean exit for certain secured lenders
- Opportunity for aggressive bidders
- Do you want to lead or follow?

Midstream Contracts in Bankruptcy Processes

Midstream Contracts in Upstream Bankruptcy Processes

- Upstream oil and gas producer can typically reject midstream contracts that are executory, subject to certain exceptions
- The current state of the law in many states are unclear as to the scope and parameters of whether midstream contracts can be rejected
- The most common “safe harbor” exception relied upon by midstream companies are that the midstream contracts constituting or containing a “covenant running with the land” (“CRWL”)
  - Cases applying the law of Oklahoma and Utah have found that midstream contracts containing “covenants running with the land” cannot be rejected.
  - Most other states have not clearly decided whether midstream contracts constituting or containing CRWLs can be rejected
- A recent case applying 363(f)(1) have found that bank and other liens that were perfected prior to the grant and/or recordation of midstream contracts that may contain CRWL prime those midstream contracts – the prior liens “wash out” post-bank lien acreage dedications
- A recent case applying 363(f)(5) found that if legal and equitable remedies (including monetary damages) are available to compensate the midstream company for the rejection of the midstream contract

The Typical CRWL Elements[1]



Key Considerations

- CRWL is a question of the applicable non-bankruptcy law governing the real property at issue
- Not all five elements may be required under a given non-bankruptcy law test; applicable CRWL tests vary from state-to-state
- Typically, the laws of the State in which the real property is located will govern; however, federal leases (onshore and offshore) may implicate federal law

1 The five-factor test depicted on this slide is based on Texas law.

The Typical CRWL Elements (con't)

** For example, Texas law applies all 5 of these factors; Colorado and Oklahoma law apply only intent, touch and concern, and privity.*

Elements of a CRWL – All elements must be satisfied to create a CRWL	
***Intent**:*	• Parties must intend for the covenant to run with the land (typically satisfied by an express "running with the land" clause in the agreement)
Touch and Concern:	• Covenant must "touch and concern" the land • Generally, covenant must either (a) restrict or relate specifically to the use or occupancy of the land itself or (b) materially impact the value or marketability of the land • This is a fact-intensive inquiry and is frequently disputed—is the crux of many recent disputes
Successors and Assigns:	• Burden of covenant must bind future owners of the land and/or the benefit of covenant must accrue to successors of the grantee • A "binding on successors/assigns" provision is frequently used to satisfy this requirement • Recording covenant or making an instrument of conveyance expressly subject to the covenant may also satisfy this requirement
Notice / Statute of Frauds:	• Successors to the burden or covenant must have notice of it • Notice may be satisfied either by "actual" notice to a successor or by "constructive" or "record" notice, where the covenant, the agreement itself, or a "memorandum" or "short form" of the agreement containing the covenant has been filed of record in the appropriate real property records
Privity of Estate:	• Depending on applicable law of the relevant jurisdiction, either or both "vertical" and "horizontal" privity may be required ➢ Vertical privity arises from the relationship between an original party to the covenant and its successors or assigns, and it is typically satisfied where the "binding on successors" element is satisfied ➢ Horizontal privity requires that the covenant be imposed in connection with a simultaneous, underlying conveyance of the real property burdened by the covenant ▪ This is a fact-intensive inquiry and is frequently disputed

Other CRWL Issues

Is the "Land" sufficiently described?

- Must satisfy recordation requirements of applicable jurisdiction -- For example, in Texas, "[A] legal description is sufficient if it contains enough facts for a party familiar with the locality to identify the premises with reasonable certainty." *Gates v. Asher*, 280 S.W.2d 247 (1955)
- In many jurisdictions, reference to other recorded documents is permissible

Is the covenant properly recorded?

- Does a memorandum provide notice? (it depends…)
- Does the memorandum include everything relevant to the CRWL in the filing

Does the Producer own the "Land"?

- Is an oil & gas lease real property? (it depends…)
- Separate vs. appurtenant real property – be careful if horizontal privity is a required element (it usually is)
- Split in the law regarding whether a CRWL relates to the producer's mineral estate or its leasehold interest

Are there prior liens or mortgages?

- Unless subordinated or subject to a non-disturbance agreement, prior perfected liens or mortgages will continue to burden any interests in real property conveyed or transferred to midstream company

Rejection of Valid CRWL

In re Chesapeake Energy Corp., Case No. 20-33233

- In *dicta,* the court preliminarily addressed whether a contract that did contain a CRWL could still be an executory contract that could be rejected, or whether the two concepts are mutually exclusive, and found that both could exist at the same time, though this portion of the opinion is *dicta* given no CRWL was found to exist in the agreement at issue
- Most courts finding a CRWL in a midstream agreement have held that the agreement cannot be rejected, but this opinion opens the door to further consideration of that issue
- *In re Southland Royalty Co. LLC* included a similar finding that nothing in the Bankruptcy Code prevents rejection of a gathering agreement, even if it contains a CRWL
- If rejected but the CRWL is valid, what next? Potential outcomes are unclear as Judge Jones said: "It does not stretch the imagination to envision a contract that contains a covenant that runs with the land and is executory," such that some future performance by the debtor is "excused" by the rejection, and some benefits bestowed on non-debtor parties remain post-rejection
  - Debtor (or 363 Buyer) does not assume the obligations under the CRWL contract
  - If Debtor (or 363 Buyer) performs the types of activities on the lands burdened by the CRWL (i.e. production of hydrocarbons), would that party be obligated to flow or process production under the CRWL contract?
  - If Debtor (or 363 Buyer) is obligated to flow or process production under the CRWL contract, is the Debtor (or 363 Buyer) obligated to perform all obligations under the contract or just those that constitute a CRWL?
  - Are MVC obligations excused?

363(f)(1) and 363(f)(5) Rejection Claims

- 363(f)(1) Rejection Claim
  - Debtor's real property was subject to a pre-existing perfected mortgage lien in favor of its RBL lenders at the time the midstream contract was executed
  - **363(f)(1) provides that a "trustee may sell property…free and clear of any interest in such property of an entity other than the estate, only if…applicable bankruptcy law permits sale of such property free and clear of such interest"**
  - *In re Southland Royalty Co. LLC* court found that under 363(f)(1), even if a CRWL existed, Southland "may step into the shoes of the RBL Lenders to extinguish [the midstream company's] interest. To not give Southland such right would put the midstream company [in a better position than it would be outside of bankruptcy and encourage state law foreclosures and corresponding lift stay motions rather than the orderly process established by the Bankruptcy Code designed to maximize value for all stakeholders"
- 365(f)(5) Rejection Claim
  - **363(f)(5) provides that a "trustee may sell property…free and clear of any interest in such property of an entity other than the estate, only if…such entity could be compelled, in a legal or equitable proceeding to accept money satisfaction of such interest"**
  - *In re Southland Royalty Co. LLC* court found that under 363(f)(5), even if a CRWL existed, the contract can be rejected as the remedies did not exclude monetary damages or otherwise limit the remedies. In fact, the court found that the entire purpose of the CRWL was to ensure that the midstream company would be paid the fees owed under the contract and that "monetary damages are an appropriate, calculable remedy"

IN RE SABINE

- *Sabine Oil & Gas Corp. v. HPIP Gonzales Holdings, LLC (In re Sabine Oil & Gas Corp.)*, 550 B.R. 59 (Bankr. S.D.N.Y. 2016) ("Sabine I"), ***aff'd***, 567 B.R. 869 (S.D.N.Y. 2017) ("Sabine II"), ***aff'd*** 734 Fed. Appx. 64 (2d Cir. May 25, 2018) ("Sabine III").
  - The covenant at issue was a dedication of "produced and saved" minerals.
  - *Sabine I:* The bankruptcy court held the gathering agreements at issue did not satisfy the requirements under Texas law to constitute a covenant running with the land. The court found that the terms and purpose of the agreements related to severed minerals (*i.e.*, "produced and saved" minerals), which are personal property under Texas law, and, therefore, the dedication did not touch and concern real property interests (*i.e.*, the debtor's *mineral estate*). Additionally, without deciding whether horizontal privity was required under Texas law, the court found the gathering agreements did not satisfy the horizontal privity requirements because the producers did not transfer any portion of a real property interest to the gatherers as part of the gathering agreements; easements were contemplated but not contemporaneously granted.
  - *Sabine II:* The district court affirmed the bankruptcy court in *Sabine I* on the ground the covenants did not touch and concern the land because the gathering agreements at issue neither increased the gatherer's legal relations to the real property interests at issue or decreased the debtor's, as required under Texas's touch and concern test.
  - *Sabine III:* The Second Circuit affirmed the district court and bankruptcy court on the ground that Texas law requires horizontal privity, and horizontal privity was not established as there was no simultaneous conveyance of a real property interest at the time the covenant was created. The Second Circuit determined it need not evaluate whether the gathering agreements touched and concerned the land.

IN RE BADLANDS

- *Midlands Midstream, LLC v. Badlands Energy, Inc. (In re Badlands Energy, Inc.)*, 608 B.R. 854, 869 (Bankr. D. Colo. 2019).
  - The dedication at issue was of "all gas reserves in and under . . . and produced or delivered from. . . (i) the Leases and (ii) other lands within the [area of mutual interest]."
  - The bankruptcy court analyzed whether the covenant at issue satisfied the CRWL requirements under Utah law.
  - The court concluded that the touch and concern element was satisfied because "by requiring Producers to dedicate their interest in oil and gas reserves, leases, and all lands within the [area of mutual interest], the Agreements affect the use, value or enjoyment of their interest in the *Leases* by limiting the right to possess, develop, and dispose of the minerals and salt water" (emphasis added).
  - The bankruptcy court explained that horizontal privity was satisfied under Utah law because the covenants at issue were created with a simultaneous conveyance of a real property interest (including an easement) to the gatherer.

IN RE ALTA MESA

- *Alta Mesa Holdings, LP, et al. v. Kingfisher Midstream, LLC, et al. (In re Alta Mesa Res., Inc.)*, 613 B.R. 90, 96 (Bankr. S.D. Tex. 2019)
  - The dedication at issue related to the "products of oil and gas leases, not products of fee mineral estates."
  - The court applied Oklahoma law, which requires consideration of the following three elements: (1) touch and concern, (2) privity, and (3) intent that the covenant pass to successors.
  - As a threshold question, the court examined which property interest of the debtor is relevant to the CRWL analysis and determined that the debtor's *leasehold interest* is the appropriate real property interest to consider in light of the fact that it is comprised of the bundle of rights necessary to search for and reduce hydrocarbons to possession, surface easements for E&P, and other rights and privileges necessary for profitable production. By focusing on the debtor's leases as opposed to its mineral estates, the court found that the gathering agreements related to that bundle of interests, including the surface easement, which is integral to the lessee's ability to realize the value of its mineral reserves.
  - The touch and concern prong was satisfied where the gathering system and grant of easement to the gatherer enhanced the value of the debtor's leases and diminished the value of the debtor's unproduced reserves.
  - Privity was also satisfied where the gathering agreement conveyed an easement to the gatherer, which the court determined was integrally tied to the purpose of, and was a crucial component of, an oil and gas lease.

IN RE EXTRACTION

- *In re Extraction Oil & Gas, Inc.* (Case No. 20-11548, Bankr. D. Del.); *Extraction Oil & Gas, Inc. v. Elevation Midstream, LLC*, Adv. Pro. No. 20-50839 (Bankr. D. Del.) [D.I. 51]; *Extraction Oil & Gas, Inc. v. Grand Mesa Pipeline*, Adv. Pro. No. 20-50816 (Bankr. D. Del.) [D.I. 45]; *Extraction Oil & Gas, Inc. v. Platte River Midstream LLC and DJ South Gathering, LLC*, Adv. Pro. No. 20-50833 (Bankr. D. Del.) [D.I. 54]
  - There are three rulings in separate adversary proceedings relating to different midstream counterparties' agreements with the debtor.
  - In all three proceedings, the court applied Colorado law, which considers the following three elements – (1) touch and concern, (2) privity, and (3) intent that the covenant pass to successors – and found no enforceable CRWL.
  - In each of the adversary proceedings, the court focused on whether the purported CRWL related to the debtor's mineral estate and determined they did not because the covenants related to personal property (severed minerals), not the mineral estate, and because any rights granted in the surface estate were wholly separate from the debtor's mineral estate.
    - As such, privity was not satisfied because the surface estate is a separate estate from the debtor's mineral estate, so any easements or rights-of-way granted were in a separate estate.
    - Touch and concern was also not satisfied because the covenants related to personal property—severed minerals—not the debtor's mineral estate (notwithstanding the fact that the dedications at issue were of the debtor's interests in some or all of the following, depending on the contract: lands, mineral interests, easements, leases, wells, and the minerals therein and thereunder, including certain leases listed on an exhibit to the agreement).
  - *These three rulings are on appeal to the Delaware District Court (as of 10/28/20).*

IN RE CHESAPEAKE ENERGY

- *In re Chesapeake Energy Corp.*, Case No. 20-33233 (Bankr. S.D. Tex. Oct. 28, 2020) [D.I. 1579]
  - Debtor sought to reject a gas purchase agreement with ETC Texas Pipeline, Ltd. ("ETC") as an executory contract, and ETC argued that it could not be rejected because it contained a CRWL.
  - As an initial matter, the Court considered the Debtors' argument that rejection (*i.e.*, breach) of the agreement would not impair any CRWL that might exist and ETCs counterarguments that a CRWL transforms an agreement such that it is not capable of rejection. **The Court, in *dicta*, opined that a contract may both contain a CRWL and be executory, and the two are not mutually exclusive. Because the Court went on to find that there was no CRWL in the agreement at issue, it stated that further analysis of this issue was moot.**
  - The Court applied Texas law on CRWL and found there was no intent to create a CRWL, that touch and concern was not satisfied, and that privity of estate was lacking.
    - Even though there was a provision stating that it was the parties' intent to create a CRWL, the Court found there was no such intent where the parties had agreed that the exclusive personal remedy for breach of the contract was the payment of a sum pursuant to a liquidated damages provision and where the agreement was stated to be a forward contract.
    - The Court found that touch and concern was not satisfied because a dedication of "produced gas" necessarily was a dedication of personal property under Texas law and that the debtor's real property rights were unaffected by the dedication.
    - Where the agreement contained no simultaneous conveyance of a real property interest to the gatherer, the Court found privity was not satisfied (to the extent horizontal privity may be required under Texas law).
  - Unlike other courts examining CRWL issues, Judge Jones made the CRWL determination in the context of a motion to reject, not in a separate adversary proceeding

IN RE SOUTHLAND ROYALTY COMPANY LLC

- *In re Southland Royalty Co. LLC*, Case No. 20-50551 (Bankr. D. Del. Nov. 13, 2020) [D.I. 262]
  - Debtor sought to reject uneconomic gas gathering agreement ("GGA"). Issues before the court were: (1) whether the GGA is an executory contract that is rejectable, (2) whether MVCs are severable or unenforceable as a restraint on alienation, (3) whether, if the GGA is rejected, debtor could revert to an older gathering agreement, and (4) whether debtor may sell free and clear of the CRWL in a § 363 sale.
  - The GGA dedicated Dedicated Properties and Dedicated Gas to the performance of the GGA and stated that it shall be a CRWL, binding on successors and assigns.
  - The Court applied Wyoming law and determined that the GGA is not and does not contain a CRWL.
    - As to intent, the Court found the dedication to "performance of the agreement" to be insufficient to have all promises in the GGA run with the land, reasoning that those obligations are personal, other than the dedication itself.
    - As to touch and concern, the Court found the covenant did not alter the debtor's legal rights in real property as it related only to produced gas, which has only an indirect effect on debtor's mineral estate.
    - As to privity of estate, the Court determined that the easements that were granted were in the surface estate, not the debtor's mineral estate, so privity was not satisfied.
  - As to whether the GGA is a rejectable executory contract, the Court found it was because, as in *Sabine* and *Extraction*, the covenants related only to personal property. The Court further determined that even if there had been a CRWL, the GGA could still be rejected in bankruptcy. The Court explained that nothing in the Bankruptcy Code prevents rejection of a gathering agreement, even if it contains a CRWL.
  - It further found that the purpose of the dedication was satisfied by the gatherer's rejection damages claims for fees and that continued enforcement of the dedication against a subsequent purchaser would be inequitable and against public policy.

IN RE SOUTHLAND ROYALTY COMPANY LLC (con't)

- *In re Southland Royalty Co. LLC*, Case No. 20-50551 (Bankr. D. Del. Nov. 13, 2020) [D.I. 262]
  - As to whether MVCs are severable or unenforceable as a restraint on alienation, the Court first explained that severability depends on intent, and here, the MVC, fees, and the dedication are inextricable and essential components of the gatherer's compensation package, so the MVC could not be severed. It further explained that the MVC was not an unenforceable restraint on alienation because its purpose is an economic term to compensate the gatherer.
  - As to whether, if the GGA is rejected, debtor could revert to an older gathering agreement, the Court said no because the contracts have distinct terms, and they cannot be rewritten to change receipt points. The contracts are not interchangeable.
  - As to whether debtor may sell free and clear of the CRWL in a § 363 sale, the Court said yes because the purpose of the dedication here is to compensate the gatherer. As such, Bankruptcy Code § 363(f)(1) and (5) were satisfied, which permit sales free and clear if such is permitted under applicable non-bankruptcy law or if an entity could be compelled in a legal or equitable proceeding to accept monetary satisfaction, respectively.

THANK YOU

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