

Rule of Three: Delaware Bankruptcy Court Again Holds Debtors Can Reject Gathering Agreements

In an April 4, 2021 bench ruling, Judge Mary F. Walrath of the Bankruptcy Court for the District of Delaware held in the *Nine Point Energy Holdings, Inc., et al., v. Caliber Measurement Services LLC, et al.*, (21-50243) adversary proceeding that the debtor-plaintiffs (“NPE”) could reject midstream gathering agreements containing dedications with their midstream service providers (“Caliber”), concluding the dedications did not contain covenants running with the land. This ruling follows two 2020 Delaware decisions reaching similar conclusions: *In re Extraction Oil & Gas, Inc.* (Judge Sontchi)¹ and *In re Southland Royalty Co. LLC* (Judge Owens).²

In *Extraction*, Judge Sontchi, applying Colorado law, held that the dedication provisions in the gathering agreements did not touch and concern the land because they dealt with personal property, i.e. crude oil “severed” from the real property. Judge Sontchi also held that the covenants did not create privity of estate because they did not convey any real property interests. One month later in *Southland*, Judge Owens made similar findings under Wyoming law.

In *Nine Point Energy*, Judge Walrath declined Caliber’s permissive abstention request and ruled on two partial summary judgment motions brought by NPE. NPE’s first summary judgment motion sought declaratory judgment as to whether the gathering agreements contained covenants running with the land. To create a covenant running with the land under North Dakota law, (1) the covenant must be contained in a grant of a real property estate; and (2) it must directly benefit the real property estate granted. Judge Walrath held, similar to *Extraction* and *Southland*, that the dedications granted Caliber an interest in personal property, not real property. Judge Walrath also found that they did not provide a direct benefit to real property interests, but rather provided only personal benefits to NPE by providing transportation of NPE’s personal property.

NPE’s second summary judgment motion sought declaratory judgment that the gathering agreements could be rejected under section 365 of the Bankruptcy Code and, if so, that the dedications and any interests granted to Caliber by those dedications must likewise be rejected. Based on Third Circuit precedent that a rejection must be *in toto*, i.e. the debtor cannot reject provisions of the contract piecemeal, Judge Walrath held that, because the gathering agreements could be rejected, the dedications must likewise be rejected. Lastly, Judge Walrath concluded that NPE could sell its assets free and clear under sections 363(f)(4) and (5) of the Bankruptcy Code respectively because there was a bone fide dispute as to Caliber’s rights and Caliber could be compelled to accept money damages to satisfy its interests.

In sum, for the third time in less than a year, the Delaware Bankruptcy Court has uniformly held that midstream gathering agreements may be rejected since the dedication provisions contained therein did not create covenants that run with the land.

¹ 622 B.R. 581 (Bankr. D. Del. 2020).

² 623 B.R. 64 (Bankr. D. Del. 2020).