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CASE STUDY

Hilltop SPV, LLC

AUSTIN, TXOVERVIEW

Hilltop, the owner of certain oil, gas, and mineral leases in Texas, inherited a gas gathering agreement (GGA) through a prior acquisition. Unfortunately, the GGA proved to be uneconomical and resulted in substantial losses under its terms. With the GGA not set to expire until 2034, Hilltop faced a long-term financial burden. The agreement conveyed two property interests to the gatherer (a mineral dedication and an easement), which both parties had agreed were covenants running with the land—a designation that historically prevented such agreements from being rejected in bankruptcy proceedings. Seeking relief, Hilltop engaged our Insolvency team to explore whether these covenants could, in fact, be challenged or set aside in bankruptcy.

Challenges

In June 2024, Hilltop filed for Chapter 11 bankruptcy under Subchapter V and immediately launched an adversary proceeding against its GGA counterparty. Hilltop sought a declaratory judgment that the GGA constituted an executory contract and was therefore eligible for rejection in bankruptcy. The gatherer, however, argued that the GGA could not be rejected because it contained covenants running with the land—a position supported by longstanding precedent in similar cases. Our challenge was to develop a legal argument that could overturn this traditional interpretation.

Industry

Energy & Natural Resources

Service

Insolvency & Commercial Bankruptcy

Legal Team

Jameson J. Watts

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Solution

Crafting a successful argument required us to address three key issues. First, we needed to conclusively demonstrate that the GGA's terms were causing Hilltop irreparable financial harm. Second, we had to establish that the GGA was, in fact, an executory contract. Only after satisfying these two points could we tackle the novel legal question: whether the presence of real property covenants in the GGA prevented its rejection in bankruptcy.

To prove the detrimental impact of the GGA on Hilltop's financial viability, we presented testimony detailing how the agreement's terms and penalties would inevitably lead to ongoing losses even after bankruptcy. In short, Hilltop's business could not survive with the GGA in place, thus meeting the deferential business judgment standard that bankruptcy courts apply to determine the best interests of the estate.

With this foundation, we then built a careful case demonstrating that the GGA was properly classified as an executory contract and that, under the Bankruptcy Code, the real property covenants did not prevent its rejection. Relying on the powerful debtor protections in Section 365 of the Bankruptcy Code, we distilled the issue to a straightforward question: "Does the inclusion of a non-rejectable covenant running with the land shield an otherwise executory GGA from rejection?" Our argument was that the plain language of Section 365 makes clear the answer is *no*.

Result

The Court ultimately agreed with our position, holding that "[b]ecause the GGA is an executory contract, Hilltop may reject the entire GGA. Covenants which convey a real property interest do not limit Hilltop's authority or power to

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reject the GGA. Covenants which convey a real property interest do not make an executory contract rejection proof. Instead, if the GGA is executory, it may be rejected, and Hilltop must deal with the consequences of such rejection." The Court further clarified that while the GGA could be rejected, any real property interests created by the covenants would survive the rejection.

The Court's decision in this case of first impression in the Western District of Texas opens up the possibility for similarly situated debtors to shed executory contracts containing real estate interests. While generally these conditions are less common, they are far more prominent in the oil and gas industry, where the decision could have a major impact on the strategic options available to lease owners undergoing financial distress.

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