Treatment of Leases, Contracts and Other Interests in Mineral Company Bankruptcy Cases

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Contractual, leasehold and real property interests are frequently the most valuable assets of a mineral debtor. The legal classification of these interests, under either bankruptcy or state law, can be determinative of the value that can be generated from these interests in a bankruptcy case. For purposes of this presentation, the following leases, contracts and interests will be addressed, all of which have been implicated in the most recent wave of coal and oil & gas bankruptcy filings: (i) mineral leases; (ii) midstream / gathering contracts; (iii) overriding royalty interests; and (iv) long-term supply contracts.

Bankruptcy Code Treatment of Leases and Contracts

Section 365 of the Bankruptcy Code allows a debtor to assume its beneficial "executory contracts" and "unexpired leases" and to reject those that are burdensome to the bankruptcy estate.[1] An "executory contract" is typically defined as a contract with material performance obligations remaining on each side.[2] An "unexpired lease" is an enforceable agreement that is classified as a 'lease' under applicable non-bankruptcy law.[3] With limited exceptions, any

[1] 11 U.S.C. § 365(a).

[2] *See e.g. Foothills Texas, Inc. v. MTGLQ Investors, L.P. (In re MTGLQ Investors, L.P.)*, 476 B.R. 143, 151-152 (Bankr. D. Del. 2012) (explaining the operation of the "Countryman" test). A minority of courts, including the Sixth Circuit Court of Appeals, follow the "functional" approach where executoriness is determined by the benefits that assumption or rejection would produce for the estate. *See e.g. Rieser v. Dayton Country Club (In re Magness)*, 972 F.2d 689, 694 (6th Cir. 1992).

[3] *See e.g. In re WRT Energy Corp.*, 202 B.R. 579, 584-585 (Bankr. W.D. La. 1996); *but see In re Aurora Oil & Gas Corp.*, 439 B.R. 674, 677, n. 4 (Bankr. W.D. Mich. 2010) ("Although property interests are 'created and defined by state law,' it does not follow that state law determines the meaning of an undefined term in a federal statute, such as the term "unexpired lease" in section 365 . . . .").

provision in an executory contract or unexpired lease that purports to terminate that contract or lease based upon a debtor's bankruptcy filing is unenforceable.[4]

Assumption & Assignment

To assume an executory contract or unexpired lease, the debtor is required to "cure" all defaults (other than those excluded by § 365(b)(2)) and to provide "adequate assurance of future performance" to the contract counterparty.[5] After assumption, the debtor may, in most instances, assign the lease or contract to a third party, notwithstanding any anti-assignment or consent provisions contained in the document.[6] In a chapter 11 case, the debtor has up to 120 days (plus 90 days of extensions) to assume a non-residential real property lease and until plan confirmation to assume all other leases and contracts, otherwise they are deemed rejected by operation of law.[7] In a chapter 7 case, the assumption deadline is sixty (60) days after the petition date, unless extended by the court for cause.[8] Pending its decision to assume or reject, the debtor must timely perform all obligations under a lease of non-residential real property.[9]

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[4] 11 U.S.C. § 365(e)(1). *See also In re Enron Corp.*, 306 B.R. 465, 472–73 (Bankr. S.D.N.Y. 2004) ("Ipso facto clauses are generally unenforceable pursuant to section 365(e) of the Bankruptcy Code because the automatic termination of a debtor's contractual rights deters rehabilitation and causes a forfeiture of assets.").

[5] 11 U.S.C. § 365(b).

[6] 11 U.S.C. § 365(f)(1). *But see* 11 U.S.C. § 365(c).

[7] 11 U.S.C. §§ 365(d)(2)-(4)

[8] 11 U.S.C. § 365(d)(1)

[9] 11 U.S.C. § 365(d)(3). *See also* 11 U.S.C. § 365(d)(5) (payment requirements regarding personal property leases). The debtor is not statutorily required to pay for services provided under other contracts pending assumption or rejection, but if the counterparty's performance is accepted by the debtor, the debtor is responsible for the reasonable cost of those services, even if the debtor ultimately elects to reject the contract. *See e.g. N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513, 531 (1984).

Rejection

In order to reject a lease or executory contact the debtor must establish, in its business judgment, that assumption of the lease would be burdensome to the estate.[10] The rejection of a contract or lease constitutes a breach of the agreement which is deemed to have occurred immediately prior to the petition date.[11] As such, lease rejection damages are only entitled to general unsecured claim status in a bankruptcy case.[12] Rejection of a contract or lease under § 365 does not, in and of itself, constitute a termination of that lease or contract – it is merely a breach that excuses performance by both parties.[13] Furthermore, rejection does not serve to unwind those portions of the lease or contract that have already been performed by the parties.[14]

Mineral Leases

Oil and Gas Leases

An oil & gas lease, in generic terms, is a grant of the right to explore, extract, sell or own the minerals in a particular tract of land for a particular period of time.[15] Even though such documents are almost always labeled as "leases," whether they are true leases that are subject to § 365 of the Bankruptcy Code is determined by applicable state law, supplemented, in certain instances, by the Bankruptcy Code.

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[10] *See e.g. In re Evans Coal Corp.*, 485 B.R. 162, 166-167 (Bankr. E.D. Tenn. 2013) (quoting *Orion Pictures Corp. v. Showtime Networks, Inc. (In re Orion Pictures Corp.)*, 4 F.3d 1095, 1099 (2d Cir. 1993)).

[11] 11 U.S.C. § 365(g)(1). *See also Miller v. Chateau Communities, Inc. (In re Miller)*, 282 F.3d 874, 876-877 (6th Cir. 2002).

[12] *Id.*

[13] *See e.g. In re CB Holding Corp.*, 448 B.R. 684, 686-687 (Bankr. D. Del. 2011).

[14] *See e.g. Stewart Title Guaranty Co. v. Old Republic Nat'l Title Ins. Co.*, 83 F.3d 735, 742 (5th Cir. 1996).

[15] *See* Patrick H. Martin and Bruce M. Kramer, Williams & Meyers, Oil & Gas Law § 202.1. pg. 21 (LexisNexis Matthew Bender 2013).

Ownership-In-Place States

In an "ownership-in-place" state, the landowner has complete ownership of the oil and gas beneath their land and, as such, when the landowner 'leases' the mineral to a third party he or she is actually transferring a real property interest.[16] This is the majority approach in the United States and is arguably the law in, among other states, Texas, Pennsylvania, and New Mexico.[17]

Typically, in "ownership-in-place" states, an oil and gas lease, as a real property interest, is not considered an unexpired lease for purposes of § 365 of the Bankruptcy Code.[18] This generalization is subject to two exceptions. First, in states that classify an oil and gas lease as a "fee simple determinable," the transferee's fee interest does not vest until it begins drilling and production. Thus, at least one bankruptcy court has determined that an unvested fee simple determinable (i.e. a lease on as yet unexplored / undrilled property) is an "executory contract" that is subject to § 365 of the Bankruptcy Code.[19] Second, certain courts have side-stepped state law and looked to § 365(m) of the Bankruptcy Code, which provides that, for purposes of § 365, "leases of real property shall include any rental agreement to use real property."[20] These courts have, therefore, determined that even if an oil and gas lease is a real property interest under

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[16] *Id.* at § 203.3, pgs. 40-46.

[17] *Id*. Decisions within states on this topic are often conflicting and thus commentators do not necessarily agree on which states have adopted the "ownership in place" or "non-ownership" theory. *Id.* at § 203, pgs. 30-31.

[18] *See e.g. In re Topco, Inc.*, 894 F.2d 727, 739, n. 17 (5th Cir. 1990); *In re Hanson Oil Co., Inc.*, 97 B.R. 468, 469-470 (Bankr. S.D. Ill. 1989); *In re Antweil*, 97 B.R. 65, 66-69 (Bankr. D.N.M. 1989); *In re WRT Energy Corp.*, 202 B.R. 579, 583-584 (Bankr. W.D. La. 1996). *But see Texaco Inc. v. Louisiana Land & Exploration Co.*, 136 B.R. 658, 668 (M.D. La. 1992) (holding that Louisiana mineral lease is real property interest and not unexpired lease, but is an executory contract subject to § 365).

[19] *See In re Tayfur*, 505 B.R. 673, 682 (Bankr. W.D. Pa. 2014).

[20] 11 U.S.C. § 365(m). *See also In re Aurora Oil & Gas Corp.*, 439 B.R. 674, 677-680 (Bankr. W.D. Mich. 2010); *In re Gasoil, Inc.*, 59 B.R. 804, 808-809 (Bankr. S.D. Ohio 1986).

applicable state law, it is still subject to § 365 because it meets the statutory § 365(m) definition (i.e. it is an agreement to use real property).[21]

Non-Ownership States

In a "non-ownership" state, the landowner does not technically own the oil and gas beneath its land, but has the exclusive right to explore and develop any oil and gas found there.[22] Although this is considered the minority position, it is the law in Kansas and Wyoming, among other states.[23] The right to explore is typically considered a personal property interest or license and the transfer of that interest is considered a true lease.[24] As such, oil and gas leases in "non-ownership" states are ordinarily considered unexpired leases or executory contracts subject to § 365 of the Bankruptcy Code.[25] Bankruptcy Courts in Oklahoma, considered by some commentators to be a non-ownership state, have held, however, that even though a lease does not create a fee interest, it is still not subject to § 365 because: (i) it is a license not a lease; and (ii) after production of oil or gas has commenced, it cannot be an executory contract.[26]

Practice Reality

Despite the extensive case law and commentary on the above classifications, much of this law has developed in the Chapter 7 context or in unique situations. In the typical large oil and gas Chapter 11 filing, it is often in the best interest of both lessors and lessees to treat the

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[21] *Id.*

[22] Williams & Meyers § 203.1, pgs. 31-32.

[23] *Id.* at pgs. 31-37.

[24] *Id.* Even though an oil and gas lease is considered a lease under this approach, the statutory assumption deadline of § 365(d)(4) may not be applicable as it only applies to leases of non-residential real property, not personal property.

[25] *See e.g. In re J.H. Land & Cattle Co., Inc.*, 8 B.R. 237, 238-239 (Bankr. W.D. Okla. 1981) (applying Kansas law).

[26] *See In re Clark Resources, Inc.*, 68 B.R. 358, 358-359 (Bankr. N.D. Okla. 1996).

debtor's oil and gas leases as leases subject to § 365 of the Bankruptcy Code. Thus, most sale / assignment motions in these cases declare that the leases are not subject to § 365, or may not be subject to § 365, but nevertheless proceed to jump through all of the statutory hoops required to assume and assign a lease or contract under § 365 (i.e. extend time deadlines, pay cure costs, etc.).

Coal Leases

In contrast to the extensive analysis of oil and gas leases in bankruptcy, it is typically assumed, with no analysis or discussion of state law, that coal leases are leases subject to § 365 of the Bankruptcy Code. This is despite the fact that a majority of coal mining states classify coal leases as some form of a real property interest.[27] All of the recent large coal Chapter 11 debtors, of which there have been many, have treated their leases as subject to assumption, assignment and rejection under § 365 of the Bankruptcy Code.

In re Manalapan Mining Co.

The exception to the above rule is the recent decision of the Bankruptcy Court for the Eastern District of Kentucky in *In re Manalapan Mining Co*.[28] In *Manalapan*, a chapter 7 bankruptcy trustee transferred a number of surface mining permits to a third party purchaser, but did not assign the underlying leases to that purchaser because the lessor (an affiliate of the debtor) had purportedly negotiated, or was in the process of negotiating, new leases with the purchaser.[29] The lessor later refused to execute the new leases and the chapter 7 trustee filed a

[27] *See e.g. Johnson v. Coleman*, 288 S.W.2d 348, 349 (Ky. 1956) (Kentucky law); *In re K&R Min., Inc.*, 103 B.R. 136, 138 (Bankr. N.D. Ohio 1988) (Ohio law).

[28] *In re Manalapan Mining Co., Inc.*, 2015 WL 3827022 (Bankr. E.D. Ky. June 19, 2015).

[29] *Id.* at *1.

motion to assign the existing leases to the purchaser.[30] The lessor objected on the grounds that the leases had been rejected as a matter of law because they were not assumed within the time period required by section 365(d)(4).[31] The trustee replied that, under applicable state law, the leases were real property interests, not true leases, and, therefore, the bankruptcy estate still possessed the right to transfer the leases.[32] Thus, the issue of whether a coal lease was a true lease or a real property interest was directly before the Bankruptcy Court (in a case where the equities clearly pointed in the trustee's favor).

The Bankruptcy Court ultimately held that the leases at issue were conveyances of real property under Kentucky law and were not leases or executory contracts for purposes of section 365.[33] The Court, therefore, concluded that the transfer of leases could still be accomplished pursuant to § 363 of the Bankruptcy Code.[34] The Court, in its carefully crafted opinion, managed to avoid many of the difficult issues arguably raised by its holding (i.e. cure costs, anti-assignment provisions, etc.).[35] Although this decision could arguably have marked a sea change in the bankruptcy treatment of Kentucky coal leases, that has not been the case.

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[30] *Id.*

[31] *Id.* at *1-2.

[32] *Id.*

[33] *Id.* at *2-3. The Court began its analysis with the proposition that "[r]egardless of [an] agreement's denomination and hybrid characteristics, under Kentucky law, what is commonly termed a coal mining lease is regarded as the conveyance of an estate or interest in the minerals as land unless the terms of the instrument require a different construction." *Id.* at *2 (quoting *Cox v. Philbeck (In re Philbeck)*, 145 B.R. 870, 871 (Bankr. E.D. Ky. 1992)). The Court then proceeded to analyze the characteristics of the specific lease at issue in the case and concluded that "the overall agreement contains usual and standard terms for a coal lease, thus leading to the conclusion that the Manalapan Mining Lease is a conveyance of an interest in real property that is not treated as a true lease under Kentucky law." *Id.* at *2.

[34] *Id.* at *3-4.

[35] *Id.* at *3 ("It is also not clear whether the failure to make the 2014 minimum royalty payment is a default or merely a claim against the estate."). *See also Id.* at *4 ("It is not necessary to pick one of these options or find a different code section to refuse to recognize any impact of the anti-assignment provision on this transaction because the Lessor cannot unreasonably withhold consent.").

Since the entry of the *Manalapan* decision, the Bankruptcy Court for the Eastern District of Kentucky, including the Judge who authored *Manalapan*, have approved the assumption and assignment of coal leases under § 365 of the Bankruptcy Code without any reference to or further discussion of *Manalapan*.[36]

Contract Integration – Patriot I

When a debtor assumes a lease or executory contract, it assumes the entire contract and must accept both its benefits and burdens.[37] Under non-bankruptcy law, multiple writings or agreements may be integrated into a single contract if it is considered to be the intent of the parties.[38] As such, whether a debtor can assume a particular benefit or obligation while avoiding another may depend entirely on whether the underlying instruments pursuant to which those benefits and obligations arise are integrated under applicable state law.[39]

In the first *Patriot Coal* bankruptcy case, Patriot Coal sought to assume certain mineral leases, which it had received pursuant to individual lease assignments executed by Massey Energy as part of a broader settlement between the parties' subsidiaries and predecessors.[40] A separate "payment agreement," executed at the same time as the assignments, granted Massey a tonnage royalty for all coal mined under the assigned leases; that royalty, however, was not

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[36] *See In re JW Resources, Inc.*, Case No. 15-60831, Docket No. 389 (Bankr. E.D. Ky. Oct. 15, 2015); *In re Fortress Resources, LLC*, Case No. 15-70730, Docket Nos. 268, 271 (Bankr. E.D. Ky. Feb. 12, 2016).

[37] *See e.g. In re Buffets Holdings, Inc.*, 387 B.R. 115, 119 (Bankr. D. Del. 2008) ("If the debtor decides to assume a lease, however, it must generally assume all the terms of the lease and may not pick and choose only favorable terms to be assumed.").

[38] *See e.g. In re AbitibiBowater Inc.*, 418 B.R. 815, 822-823 (Bankr. D. Del. 2009)

[39] *Id.* at 823 ("[A]ll of the contracts that comprise an integrated agreement must either be assumed or rejected, since they all make up one contract.").

[40] *Eastern Royalty LLC v. Boone East Development Co. (In re Patriot Coal Corp.)*, Adv. Pro. No. 12-4354, Docket No. 31, Findings of Fact and Conclusions of Law, at *1-7 (Bankr. E.D. Mo. Nov. 14, 2013).

referenced in the assignments themselves.[41] Patriot took the position that the "payment agreement" was not an executory contract and, more importantly, was not integrated with the lease assignments. As such, Patriot argued that it was a pre-petition obligation that could be disregarded upon assumption of the leases (i.e. Patriot could continue to mine the leases, but would not owe an overriding royalty to Massey).[42]

Despite the fact that the parties clearly intended (based on extrinsic evidence which was presented to but not considered by the court) that the individual agreements were to be treated as a unified whole, the Bankruptcy Court ruled that the agreements should not be integrated and that the "payment agreement" standing alone was merely a pre-petition non-executory contract.[43] This case (which was appealed and settled prior to an appellate decision) stands in contrast to the likely outcome, discussed below, where an assignor's retention of an overriding royalty interest in a coal lease is properly documented to ensure its integration with the lease and/or its treatment as an unseverable real property interest under state law.

Interests Running With the Land

A number of economic interests in the mineral business, whether classified as real property interests or something else, directly relate to the underlying mineral estate and presumably cannot be severed from that estate. These interests (i.e. covenants, easements, royalty interests, etc.) obtain that status, in part, because they are deemed to "run with the land." The test to determine whether a given interest "runs with the land" differs from state to state, but generally there must be privity (vertical and sometimes horizontal) between the parties, the

[41] *Id.*

[42] *Id.* at *8-9.

[43] *Id.* at *15-27.

interest must "touch and concern" the land, and there must be an intent that the interest or covenant at issue bind successors-in-interest.[44]

If an interest "runs with the land," a debtor cannot sell an asset "free and clear" of that interest, nor can it reject the agreement that creates and/or documents that interest.[45] Thus, creditors and counterparties of a debtor have a clear incentive to declare that their particular interest or agreement is one that "runs with the land."

Midstream / Gathering Agreements

In order to effectively to market and sell oil, gas, and other liquids, it is necessary for the producer to transport those products, frequently by pipeline, to processing facilities and sales hubs. Midstream companies build this underlying infrastructure and provide these services to producers. Typically, a midstream operator enters into a "gathering agreement" or "gathering and processing agreement" with an oil and gas producer, pursuant to which the oil and gas producer dedicates the entirety of its oil and gas production from a particular geographic area to the midstream operator (i.e. the producer must use the operator's services for all dedicated production for the life of the contract).[46] The long-term and committed nature of these contracts provides the security necessary for operators to facilitate the financing and construction of gathering systems.[47] As such, it had typically been understood that these contracts were

[44] *See e.g. Allred v. Dietrich*, 2010 WL 323279, at *2 (Ky. App. Jan. 29, 2010) (applying Kentucky law regarding covenants running with the land).

[45] *See e.g. Foothills Texas, Inc. v. MTGLQ Investors, L.P. (In re MTGLQ Investors, L.P.)*, 476 B.R. 143, 149 (Bankr. D. Del. 2012); *Gouveia v. Tazbir*, 37 F.3d 295, 298-300 (7th Cir. 1995); *In re Three A's Holdings LLC*, 364 B.R. 550, 555-556 (Bankr. D. Del. 2007).

[46] *See* McGuire Woods LLP, *Can Gathering Agreements Be Rejected as Executory Contracts?* (Mar. 10, 2016), available at: https://www.mcguirewoods.com/Client-Resources/Alerts/2016/3/RI-Update-Hot-Topics-Oil-Gas-Restructurings-Volume-2.aspx.

[47] *Id.*

essentially covenants or easements that bound the producer and any successor or assigns of the mineral property. This understanding has been altered by recent efforts to reject midstream gathering agreements on the basis that they are merely executory contracts and do not "run with the land."

In re Sabine Oil & Gas

In *Sabine*, the debtors sought to reject certain gathering agreements that contained minimum volume commitments and required "deficiency payments" in the event such commitments were not fulfilled.[48] The midstream operator objected and argued that, under applicable Texas law, the gathering agreements were covenants that ran with the land because (i) the agreements specifically provided that they ran with the land and were binding on successors and assigns; and (ii) the 'dedication' language conveyed a real property interest in the hydrocarbons subject to the debtor's lease.[49]

In a two-stage decision,[50] the Bankruptcy Court for the Southern District of New York ruled that the midstream agreements did not run with the land and could be rejected by the debtors.[51] The Court determined that the agreements did not "run with the land" because: (i) there was no horizontal privity as there was no conveyance of the mineral estate, only the right to transport gas, which is not a part of the mineral estate; and (ii) the agreement did not

[48] *In re Sabine Oil & Gas Corp.*, 547 B.R. 66 (Bankr. S.D.N.Y. 2016).

[49] *Id.* at 75-79.

[50] The Bankruptcy Court determined that, as a matter of procedure, it could not rule on whether the agreements "ran" with the land in the context of a motion to reject an executory contract, even though that determination was critical to its rejection decision. *Id. at* 79-80. Thus the Court granted the motion to reject based on its "non-binding" conclusion that the agreements did not run with the land and only issued a final decision on the status of the agreements after the debtor jumped through the necessary procedural hoops of filing an adversary proceeding. *See In re Sabine Oil & Gas Corp.*, 551 B.R. 132, 136 (Bankr. S.D.N.Y. 2016) (describing procedural history).

[51] *In re Sabine Oil & Gas Corp.*, 547 at 71-79.

"touch and concern" the land because it focused on the oil and gas extracted from the ground which, under Texas law, constituted personal property rather than real property.[52] At the time of the *Sabine* decision, the debtors in the *Quicksilver Resources* and *Magnum Hunter* bankruptcies had also sought to reject large gathering agreements with their midstream counterparties. After the issuance of the *Sabine* decision, the issue was consensually resolved in both of these cases. That is not to say that this issue is fully settled, however, as it is dependent, at least in part, upon the language of the particular gathering agreement and applicable state law. In fact, the reasoning of *Sabine* is being disputed, and distinguished, by a midstream company in an adversary proceeding currently pending in the *Emerald Oil* bankruptcy.[53]

Overriding Royalty Interests

An overriding royalty interest, in both the coal and oil and gas context, is generally defined as the right to share in the production value of mineral rights free of the costs of production.[54] In those states that the view the underlying mineral lease or interest as an interest in real property, a properly drafted overriding royalty interest also constitutes an interest in real property.[55] If the agreement is not carefully drafted, if the interest arises separate and apart from an assignment of the subject lease, or if the underlying mineral interest on which the royalty is granted is not considered an interest in real property, the overriding royalty interest is merely

[52] *Id.* at 76-78.

[53] *See Emerald Oil Inc. v. Dakota Midstream, LLC (In re Emerald Oil Inc.)*, Adv. Pro. No. 16-50998, Docket No. 30 (Bankr. D. Del. Sept. 15, 2016).

[54] *See e.g. Western Ky. Royalty Trust v. Armstrong Coal Reserves, Inc.*, 2012 WL 5949478, at *9-10 (W.D. Ky. Nov. 28, 2012); *In re Foothills Texas, Inc.*, 476 B.R. at 149 ("In standard oil and gas parlance, the term 'overriding royalty' means a given percentage of gross production carved out of the working interest in the land, but, by agreement, not chargeable with any expenses of operation."); *In re Alpha Natural Resources, Inc.*, 2016 WL 4272236, at *4 (Bankr. E.D. Va. Aug. 11, 2016).

[55] *See e.g. Delta Petroleum Gen. Recovery Trust v. BWAB LLC (In re Delta Petroleum Corp.)*, 2015 WL 1577990, at *8 (Bankr. D. Del. Apr. 2, 2015); *EOG Resources Inc. v. Hanson Prod. Co.*, 94 S.W.3d 697, 700 (Tx. App. 2002); *Gognat v. Ellsworth*, 2009 WL 3486627, at *6 (W.D. Ky. Oct. 26, 2009).

deemed a contractual right to payment or a personal property interest.[56] As discussed above in the leasehold context, this classification will ultimately determine whether a debtor can reject the royalty interest or assign / sell a mineral lease free and clear of that interest.

If an overriding royalty interest is characterized as a real property interest and/or a covenant that runs with land and burdens the mineral estate, a debtor cannot sell or assign a mineral lease free and clear of the royalty interest.[57] In part, this is because, the royalty interest has been retained by the lessee and is, therefore, not property of the debtor's bankruptcy estate subject to alienation.[58] In the *Patriot* decision referenced above and in a recent decision in the *Alpha Natural Resources* bankruptcy, the courts determined that specific overriding royalty interests did not run with the land and/or were mere payment obligations subject to rejection by the debtor. The distinguishing feature of these case, however, was that the royalty interests were created pursuant to separate settlement agreements and were not included in the lease assignments or drafted in a manner that evidenced their status as excluded real property interests.[59]

In the *Walter Energy* case, the Bankruptcy Court looked to state law to determine whether an overriding royalty interest in an oil and gas lease was subject to rejection by the debtor.[60] The Court held that since an oil and gas lease was considered a lease of personal

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[56] *See e.g. In re Walter Energy, Inc.*, 2015 WL 9487718, at *5-7 (Bankr. N.D. Al. 2015) ("[I]f a lease is in the nature of personal property, a royalty interest in that lease will also be characterized as personal property."); *In re Alpha Natural Resources, Inc.*, 2016 WL 4272236, at * 4 (holding that a purported overriding royalty interest was merely a payment right because the agreement did not contain words of real property conveyance and the payment term was not co-extensive with the underlying lease).

[57] *In re Foothills Texas, Inc.*, 476 B.R. at 156-157; *In re Osyka Corp.*, 426 B.R. 653, 662 (Bankr. S.D. Tex. 2010).

[58] *See cf* 11 U.S.C. § 541(b)(4)(B).

[59] *See supra* n. 41, 53.

[60] *In re Walter Energy, Inc.*, 2015 WL 9487718, at *5-7.

property under Alabama law, an overriding royalty interest in that same lease must also be a personal property interest and, as such, could be rejected independent of the mineral lease.[61]

Long Term Supply Contracts

Supply contracts of more than one year are common in both the coal and oil gas industries. Given the recent market declines in both industries, long term supply contracts with prices fixed at above-market rates can be valuable assets of a bankrupt mineral debtor. These contracts are typically considered "executory contracts" and can be preserved or monetized through assumption and assignment to a third party.[62] From the perspective of the contract counterparty, however, these contracts are significant liabilities and the bankruptcy filing of the debtor may, under certain circumstances, create an opportunity to stop the figurative bleeding.

Forward Contract / Swap Agreement

As noted above, the general rule is that any provision in a contract which authorizes termination of that contract based upon one party's bankruptcy filing is unenforceable.[63] This is not true, however, if the subject contract is a "forward contract" with a "forward contract merchant" or a "swap agreement" with a "swap participant," as those terms are defined in the Bankruptcy Code.[64] If these sections are applicable, which may be the case with certain long

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[61] *Id.*

[62] *See e.g. Avoco Bement Corp. v. Canadian Nat'l Rail. Co. (In re Newpage Corp.)*, 517 B.R. 508, 514-515 (Bankr. D. Del. 2014).

[63] 11 U.S.C. § 365(e)(1).

[64] *See* Daniel I. Waxman, *Shipping Coal Through Safe Harbors: Application of the Bankruptcy Code Safe Harbors to Coal Supply Agreements*, 53 U. Louisville L. Rev. 229 (2015).

term supply contracts, the non-debtor counterparty can enforce any contractual provision which authorizes termination of the contract based on a bankruptcy filing.[65]

Recent Examples

The South Carolina Electric & Gas Co. has attempted to use the forward contract / swap agreement 'safe harbors' to terminate above-market supply contracts in two recent bankruptcy cases in the Eastern District of Kentucky.[66] In both instances, the disputes were settled based on a monetary payment by the state power company in order to buy-out the remaining term of the supply contracts.[67] South Carolina's arguments in both instances were complicated by its delay in seeking termination[68] and its status as an end-user rather than a true forward contract merchant.[69] This issue also arose on two separate instances in the *Alpha Natural Resources* bankruptcy – these disputes were also resolved in a consensual manner.[70]

[65] *Id.* at 231.

[66] *In re Licking River Mining, LLC*, Case No. 14-10201, Docket No. 934 (Bankr. E.D. Ky. Feb. 19, 2015); *In re JW Resources, Inc.*, Case No. 15-60831, Docket No. 317 (Bankr. E.D. Ky. Sept. 29, 2015).

[67] *In re Licking River Mining, LLC*, Case No. 14-10201, Docket No. 1096 (Bankr. E.D. Ky. Mar. 20, 2015); *In re JW Resources, Inc.*, Case No. 15-60831, Docket No. 374 (Bankr. E.D. Ky. Oct. 8 2015).

[68] A counterparty who seeks to terminate a forward contract based upon a bankruptcy filing must act promptly after the filing and any failure to do so may constitute a waiver of its right to terminate. *See* Waxman, *Shipping Coal Through Safe Harbors*, 53 U. Louisville L. Rev. at n. 14 (citing cases).

[69] The majority of courts define a "forward contract merchant" so as to exclude an entity that is acting as a producer or end-user of the commodity that is the subject of the contract. *Id.* at 241-243.

[70] *In re Alpha Natural Resources, Inc.*, Case No. 15-33896, Docket Nos. 1847 (Bankr. E.D. Va. Mar. 24, 2016) and 1847 (Bankr. E.D. Va. July 28, 2016).