

NAVIGATING THE REJECTION MAZE: COVENANTS RUNNING WITH THE LAND & PROPERTY INTERESTS IN BANKRUPTCY

A recent decision from the Bankruptcy Court for the Western District of Texas addressed the intersection of property interests—specifically, covenants running with the land in a gas gathering agreement—and the ability to reject an agreement containing such interests.¹ The key takeaways are as follows:

- Executory contracts containing covenants running with the land or otherwise conveying real property interests can be rejected under Section 365 of the Bankruptcy Code.
- Unless otherwise provided for in the contract, a debtor's rejection of an executory contract does not reject any real property interests conveyed by covenants in the contract, and the real property interest conveyed by the covenant survives rejection.
- A court may be called upon to determine whether and to what extent a covenant running with the land or property interest was created under an executory contract and survives its rejection.
- Although not addressed in *Hilltop* due to a waiver of damages clause, a question exists as to whether injunctive relief, specific performance, or other equitable remedies may be available to the non-debtor counterparty to a rejected contract.

Hilltop SPV, LLC ("**Hilltop**") owned oil, gas, and mineral leases in the Hilltop Lakes in Leon and Robertson Counties, Texas. Through a prior acquisition, Hilltop became party to a Gas Gathering Agreement ("**GGA**") with Monarch Midstream, LLC ("**Monarch**"), whereby Monarch would gather gas at Hilltop's wellheads, compresses it, and then distribute the gas to various points for further distribution by Hilltop. The GGA contained a minimum volume requirement and provided for "liquidated and agreed damages for [the volume] not being delivered."²

¹ *In re Hilltop SPV, LLC*, 667 B.R. 110 (Bankr. W.D. Tex. 2025).

² *Id.* at 114.

The GGA created two property interests that both Hilltop and Monarch agreed were *covenants running with the land*:

- Hilltop granted Monarch a right of way and easement across Hilltop's leases to access Monarch's equipment.
- Subject to Hilltop's reservations, Hilltop dedicated to Monarch all gas reserves in, under, and produced from Hilltop's leases in a specified area.

These interests were to exist for the life of the GGA (until November 2034).

Upon filing for bankruptcy, Hilltop sought to reject the GGA.³ Hilltop's position was that the GGA was executory and capable of being rejected; however, any real property covenants (which Hilltop conceded existed) continued to survive post-rejection. Monarch, on the other hand, believed that the GGA was not executory because of the covenants running with the land and, therefore, the entire agreement was immune from rejection.

Was the GGA Executory? The Bankruptcy Court first analyzed whether the GGA was executory. Applying a common analysis to the question, the Bankruptcy Court noted that in the Fifth Circuit, courts ask "whether, under the relevant state law governing the contract, each side has at least one material unperformed obligation as of the petition date."⁴ In examining the GGA and the performance due on each side, the Bankruptcy Court noted the following:

- With respect to Hilltop – Hilltop had material obligations as it was required to pay Monarch gas gathering and compression fees and meet its minimum volume requirements.
- With respect to Monarch – Monarch met its obligation to construct the new compression system, but the GGA also required Monarch to "own" and "operate" the completed compression station. After assigning the ordinary and generally accepted meaning of those terms written in the present tense, the Bankruptcy Court determined that Monarch had continuing obligations, and such obligations were material.

Thus, material performance was required on both sides of the GGA, and the GGA was executory.

Did the Existence of Covenants Running with the Land Immunize the GGA from Being Rejected? Monarch contended that, because the GGA contained covenants running with the land, it could not be rejected despite being executory in nature. The Bankruptcy Court—characterizing this as a question of first impression—began its analysis with the Bankruptcy Code, noting that Section 365 allows a debtor to reject *any* executory contract.⁵ The Bankruptcy Court further noted that the Bankruptcy Code does provide some limitations to rejection,

³ Procedurally, Hilltop filed an adversary proceeding (a complaint) seeking a declaratory judgment that the GGA was an executory contract capable of being rejected. Subsequently, Hilltop amended its complaint and separately filed a rejection motion. The Bankruptcy Court only addressed whether the GGA was executory and whether it could be rejected, and reserved for the adversary proceeding the question of what covenants ran with the land post-rejection.

⁴ *Id.* (quoting *Argonaut Ins. Co. v. Falcon V, L.L.C. (Matter of Falcon V, L.L.C.)*, 44 F.4th 348, 352 (5th Cir. 2022)).

⁵ 11 U.S.C. § 365(a).

including requiring Bankruptcy Court approval⁶ and allowing the purchaser in a land sale contract rejected by the trustee to opt to treat the contract as terminated or remain in possession of the land and offset damages⁷; however, the Bankruptcy Code does not prohibit a Chapter 11 debtor from rejecting an executory contract containing real property interests. "The Code does not say a chapter 11 debtor cannot reject an executory contract containing real property interests. The [Bankruptcy] Rules do not say this either."⁸ In fact, it expressly provides that landlords and tenants can reject leases or assign them to a new party, even though the leases involve grants of interest in real property.⁹

The Bankruptcy Court also cited Judge Sontchi in *Extraction Oil & Gas*, stating "[m]ost Courts that have held covenants running with the land cannot be rejected have found the covenant was not an executory contract."¹⁰ The Bankruptcy Court further noted that "[t]his is not the same, however, as saying an executory contract which contains a covenant running with the land cannot be rejected."¹¹ Citing other cases such as *Southland Royalty Co.*¹², *In re Chesapeake Energy Corp.*¹³, and *In re Sanchez Energy Corp.*¹⁴, the Bankruptcy Court found that the covenants that convey a real property interest do not limit the power or authority to reject an executory contract.

Effect of Tempnology. In its decision, the Bankruptcy Court notes that Congress chose to outline the consequences of a rejection, rather than restricting the ability of a Chapter 11 debtor to reject. Specifically, Section 365(g) of the Bankruptcy Code provides that "the rejection of an executory contract or unexpired lease of a debtor constitutes a breach of such contract or lease."¹⁵ As a result, the contract is not considered rescinded, but rather the counterparty has the same rights as if the debtor had breached the contract in a non-bankruptcy context. This is emphasized in the recent Supreme Court decision, *Tempnology*. In that case, the Supreme Court held that "[a] rejection breaches a contract but does not rescind it. And that means all that would ordinarily survive a contract breach, including those conveyed here, remain in place."¹⁶

Notably, the Bankruptcy Court focused on Judge Isgur's discussion on the issue in *Sanchez*, stating "Judge Isgur concluded that because a party's breach of a contract that includes a covenant conveying a real property interest does not result in the property interest returning to the breaching party, a debtor's rejection of an executory contract does not reject any real property interests conveyed by covenants in the contract. Instead, the real property interest conveyed by the covenant survives rejection."¹⁷

⁶ *Id.*

⁷ *Id.* § 365(i).

⁸ *Hilltop*, 667 B.R. at 118.

⁹ 11 U.S.C. § 365(a), (g), (k).

¹⁰ *In re Extraction Oil & Gas*, 622 B.R. 608, 620–21 (Bankr. D. Del. 2020).

¹¹ *Hilltop*, 667 B.R. at 119.

¹² *Southland Royalty Co. v. Wamsutter LLC (In re Southland Royalty Co.)*, 623 B.R. 64, 73–74, 90–92 (Bankr. D. Del. 2020).

¹³ *In re Chesapeake Energy Corp.*, 622 B.R. 274, 281–82 (Bankr. S.D. Tex. 2020).

¹⁴ *Occidental Petroleum Corp. v. Sanchez Energy Corp. (In re Sanchez Energy Corp.)*, 631 B.R. 847, 851, 859–60 (Bankr. S.D. Tex. 2021).

¹⁵ 11 U.S.C. § 365(g).

¹⁶ *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 587 U.S. 370, 372 (2019).

¹⁷ *Hilltop*, 667 B.R. at 119 (citing *Sanchez*, 631 B.R. at 860).

Although not the focus of the *Hilltop* decision, an interesting question arose regarding the ability of a non-debtor counterparty to, in line with *Tempnology*, seek injunctive relief or specific performance because of the breach caused by a debtor's rejection. In a footnote, the Bankruptcy Court noted that Monarch argued that it could seek injunctive relief. The Bankruptcy Court further noted that the GGA contained a provision allowing injunctive relief in an arbitration clause; however, such a clause conflicted with a waiver of damages provision, which stated that "direct actual damages shall be the sole and exclusive remedy, and all other remedies or damages at law or *in equity* are waived." (emphasis added).¹⁸

Conclusion & Takeaway. Executory contracts containing covenants running with the land or otherwise conveying real property interests can be rejected under Section 365 of the Bankruptcy Code. The effect of such rejection, however, does not relieve a debtor of the burdens of real property interests conveyed by such covenants. However, courts may be called upon to determine whether and to what extent a covenant running with the land or property interest was created under an executory contract and survives its rejection. To the extent a court determines that no covenant running with the land or property interest was created, the non-debtor counterparty may be left solely with an unsecured damages claim resulting from the contract rejection – which claim may receive little to no recovery, depending on the case.

¹⁸ *Id.* at 114 n.8.

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