

GOLDEN V. SM ENERGY COMPANY AND THE QUESTION OF
WHETHER AN AREA OF MUTUAL INTEREST COVERING OIL
AND GAS RIGHTS IS BINDING ON SUCCESSORS AND
ASSIGNS

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ABSTRACT

Clauses providing for an “Area of Mutual Interest” (“AMI”) are common features on agreements between oil and gas lessees, including joint operating agreements and various other agreements under which lessees agree to share in the exploration for, and production of oil and gas. AMI clauses typically provide that if one party to the agreement acquires an oil and gas interest it is required to offer to convey, or in some cases, simply convey, a portion of that interest to the other parties to the agreement. This Article will begin with a description of AMIs, including a description of two types: the Standard AMI and the Override AMI. This Article will also include a discussion of why the AMI is used. It will discuss the requirements for an AMI’s validity under the Statute of Frauds and the Rule Against Perpetuities, and discuss the question of whether the AMI is binding on successors and assigns, beginning with the requirement that such successors and assigns must have actual or constructive notice of the AMI, and then it will address the question of whether an AMI is a covenant running with the land. Finally, it will analyze the recent North Dakota Supreme Court case of *Golden v. SM Energy Company* regarding the question of whether a successor to an agreement containing an AMI otherwise agreed to be bound by the terms thereof.

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I. INTRODUCTION

An Area of Mutual Interest (“AMI”) is an agreement among a group of parties that describes an area of land and provides that, if any of the parties acquire an oil and gas interest¹ located in that area, the other party or parties to the AMI will have the option to share in that interest. There is a wide range in the amount of land that may be covered by an AMI. As one authority notes, “[a]n AMI may be a small ‘buffer zone’ around the edge of the contract area covered by a joint operating agreement, or if agreed to in anticipation of a large seismic shoot, it may be hundreds of square miles in

1. There are various types of oil and gas interests, including: (1) the interest of a lessee under an oil and gas lease, which is often referred to as a working interest, *see* PATRICK H. MARTIN & BRUCE M. KRAMER, WILLIAMS & MEYERS MANUAL OF OIL & GAS TERMS 1147 (15th ed. 2012) [hereinafter, WILLIAMS & MEYERS MANUAL OF OIL & GAS TERMS]; (2) the interest in the minerals, which may be owned by the owner of the fee simple interest in the land, or may be severed and owned separately, *see id.* at 606-07; and (3) various types of royalty interests, including: (a) the royalty reserved under an oil and gas lease, *see id.* at 922; (b) a non-participating royalty that is created out of a fee mineral interest, which does not include the right to grant an oil and gas lease, and does not participate in the bonus or rentals payable under a lease, *see id.* at 670; and (c) an overriding royalty that is in addition to the royalty reserved by the lessor under an oil and gas lease, *see id.* at 726. Agreements under which a party has a right to acquire oil and gas leases or other interests held by another party, generally by drilling wells, may also be considered oil and gas interests; the most common of these is referred to as a “farmout agreement.” *See id.* at 358-59. Herein, unless otherwise indicated, the term “oil and interests” will be used to refer to all of these types of interests.

area.”² Generally, when parties enter into an AMI, they are contemplating the acquisition of oil and gas leases within the specified area. However, AMIs may also, intentionally or inadvertently, cover the acquisition of other types of oil and gas interests.³ AMIs have long been a feature of oil and gas operations in the United States, including operations in North Dakota,⁴ and there have been many articles and papers devoted, in whole or in part, to discussing AMIs and their application.⁵

The purpose of this article is to: (1) describe the AMI’s terms; (2) explain why it is used; (3) address two fundamental requirements for its validity, compliance with the Statute of Frauds, and the Rule Against Perpetuities; and (4) address in some detail the issue of when the terms of an AMI are binding on successors and assigns. This Article will focus on North Dakota law and will refer to sources of that law whenever they are available. It should also be noted, however, that cases from other jurisdictions will be cited where North Dakota authority is not available. Such cases will provide additional support for North Dakota’s position, provide examples that may not be available from North Dakota authority, or contrast a different approach that may be taken in other jurisdictions.

II. THE TWO TYPES OF AMIs

In preparing this article, I determined that AMIs may actually be divided into two types, which will be referred to herein as: (1) the Standard AMI; and (2) the Override AMI. The reason for this division is that, as will be discussed below, while the two types have much in common, the Override AMI differs from the Standard AMI in some fairly significant

2. Terry I. Cross, *The Ties that Bind: Preemptive Rights and Restraints on Alienation that Commonly Burden Oil and Gas Properties*, 5 TEX. WESLEYAN L. REV. 193, 215 (1999) [hereinafter Cross].

3. *Id.* at 217, noting:

[E]ven though AMIs are typically entered into at a time when oil and gas leases are being acquired, the language of the AMI is usually broad enough to include almost any acquisition. Mineral fees, farmouts and subleases usually are meant to be covered, since like a lease acquisition, they are exploration opportunities. But is the acquisition of producing properties covered? What about overriding royalties? Typical AMI language will require a party to share any acquisition, but if the issue is raised at the drafting stage, parties usually agree to exclude producing properties.

4. Anita Gefreh Himebaugh, *An Overview of Oil and Gas Contracts in the Williston Basin*, 59 N.D. L. REV. 7, 32 (1983) [hereinafter Himebaugh].

5. See, e.g., Allen D. Cummings, *Old AMIs—New Problems*, ANN. ERNEST E. SMITH OIL, GAS & MINERAL L. INST. (2006); Scott Lansdown, *Recent Challenges to Area of Mutual Interest Agreements*, ANN. ERNEST E. SMITH OIL, GAS & MINERAL LAW INST. (2002); Cross, *supra* note 2, at 215; Matthew A. Thanheiser, *Area of Mutual Interest Clauses and Agreements*, ANN. OIL, GAS & MINERAL L. INST. (1992) [hereinafter Thanheiser]; Dante L. Zarlengo, *Area of Mutual Interest Clauses Regarding Oil and Gas Properties: Analysis, Drafting, and Procedure*, ROCKY MTN. MIN. L. INST. (1983).

respects. It is interesting to note that insofar as I have been able to determine, none of the authorities that have discussed AMI's over the years have recognized the differences between the Standard AMI and the Override AMI.⁶ In fact, I confess that the distinction between the two types of AMIs was not noted in my earlier work on AMIs, and I only identified it while working on this Article. I apologize if there are authorities I may have overlooked, that did, in fact, recognize these differences.

A. THE STANDARD AMI

Initially, it should be noted that AMIs are typically not entered into in isolation. Instead, they are generally incorporated in other agreements covering a venture between parties to exploit oil and gas resources, such as an exploration agreement,⁷ a type of agreement that is somewhat less well defined in the oil and gas industry than some other types of agreements. As one authority notes:

A variety of agreements are often loosely referred to as exploration agreements and participation agreements. One type of contract commonly designated an exploration agreement permits a company to conduct geophysical exploration over a specified area and to select a specified amount of acreage within this area once the exploration has been concluded . . . Farmouts in which one party agrees to assign an interest in leased acreage in exchange for another party's drilling one or more test wells may also be called exploration agreements.⁸

It should be noted that the standard form of Joint Operating Agreement ("JOA"), which is the agreement that parties typically enter into to conduct joint oil and gas operations,⁹ does not contain an AMI provision,¹⁰ except

6. See, e.g., *supra* note 5. One of the authorities does note that an agreement may contain both the standard AMI provisions and the requirement for the grant of an overriding royalty. See Cross, *supra* note 2, at 216.

7. See Zarlengo, *supra* note 5, at 838-39 ("An area of mutual interest clause is commonly used in contracts pertaining to an area wherein little exploration has previously occurred. The contract itself usually provides for exploration by drilling of one or more exploratory wells, by geophysical operations, or by other geologic and scientific means."). See also Himebaugh, *supra* note 4, at 32. AMIs may also be included in Joint Operating Agreements, Gary B. Conine, *Property Provisions of the Operating Agreement—Interpretation, Validity and Enforceability*, 19 TEX. TECH. L. REV. 1263, 1345 (1988) [hereinafter Conine], and farmout agreements; see John S. Lowe, *Analyzing Oil and Gas Farmout Agreements*, 41 SW. L.J. 759, 844-46 (1987).

8. 3 ERNEST E. SMITH & JACQUELINE L. WEAVER, TEX. LAW OF OIL & GAS, § 16.4[B] (2d ed. 2013). For a detailed description of exploration agreements, see Karen E. Lynch, *Diagram of an Exploration Agreement: Legal and Practical Documentation Pointers and Participants*, 43 ROCKY MTN. L. INST. 17-1 (1997).

9. See John R. Reeves & J. Matthew Thompson, *The Development of the Model Form Operating Agreement: An Interpretive Accounting*, 54 OKLA. L. REV. 211, 213 (2001) ("The

for a very limited clause governing the renewal and extension of leases.¹¹ AMIs are, however, sometimes added to JOAs.¹² Where an AMI is not added to a JOA the parties thereto do not have the right to share in leases acquired by one of the other parties, other than those which fall within the renewal and extension clause, even if they are within the area covered by the JOA.¹³

Although there is no standard “model form” of AMI,¹⁴ and there is a wide variety in the types of AMI agreements, virtually all of what will be referred to herein as Standard AMIs contain certain key terms: (1) a description of the area covered; (2) a provision that if any party to the AMI acquires an oil and gas interest within the AMI,¹⁵ they will provide a notice to the other parties that includes a description of the interest and the consideration paid by the acquiring party in obtaining it;¹⁶ (3) a provision that the other parties have the option, but typically not the obligation, to acquire their proportionate part of the acquired interest by giving notice of

American Association of Petroleum Landmen (“AAPL”) Form 610 Model Form Operating Agreement has been in use in the oil and gas industry in one form or another since 1956. The various versions of the Model Form Operating Agreement continue to be widely used.”)

10. See Cross, *supra*, note 2, at 216; Conine, *supra* note 7, at 1345. But see Kinkcaid v. Western Operating Co., 890 P.2d 249, 253 (Colo. App. 1994) (holding that a JOA was ambiguous as to whether it covered subsequently acquired leases, and upholding the trial court’s finding that the evidence demonstrated that it was the parties’ intent that it do so). Interestingly, the court noted that the party claiming that the JOA did not cover newly acquired leases had cited “two law review articles” indicating that a standard form of JOA does not create an AMI unless the parties expressly provide that it does. *Id.* at 252. The court does not identify the law review articles, but it may be reasonably speculated that they were the Cross and Conine articles. In any event, the court held that since the articles were not cited in the trial court decision, they could not be considered on appeal.

11. See, e.g., Am. Ass’n of Petroleum Landmen Form 610-1989 Model Form Operating Agreement, art.VIII.B. In Stewart v. Hauptman, No. 04-547 2007 WL 1977763 at *5 (Mont. 2007), the Montana Supreme Court ruled that the terms of an AMI conflicted with the renewal and extension provision of the JOA and held that the terms of the AMI prevailed because of the provision concerning conflicts in the agreement containing the AMI and the behavior of the party that sought to avoid the AMI. *Id.* at *5.

12. See Thanheiser, *supra* note 5, at 4.

13. See Clovelly Oil Co. v. Midstates Petro. Co., 112 So.3d 187, 196 (La. 2013). In that case the non-acquiring party argued that the JOA would automatically cover new leases. The court noted that this would render the clause of the JOA allowing the parties the option to participate in renewal or extension leases virtually without effect. *Id.* at 195. The court also noted that this result would, unlike the standard AMI clause, deprive the parties of the option to participate, or not participate in the acquired leases, and that, as a result “[t]he JOA parties would have no reasonable way to manage or predict the risks they might incur after they entered into a JOA with another party.” *Id.* at 196.

14. Cross, *supra* note 2, at 217.

15. Herein the term “AMI” will sometimes be used to refer to the area covered by the AMI.

16. In Mountain Fuel Supply Co. v. Chorney Oil Co., 335 F. Supp. 59, 64-65 (D. Wyo. 1971), the court held that, where the AMI only required that a party “shall promptly notify,” the other party of the acquisition of an interest, written notification was not required, and that notice by telephone, followed by the provision of maps showing the location of the acquired interest, was sufficient.

their election to participate in the acquisition¹⁷ and paying their proportionate part of the consideration paid by the acquiring party¹⁸ within a specified period of time;¹⁹ and (4) a specification of the proportion of the interest a party has the right to acquire in the oil and gas interest.²⁰ More elaborate AMIs may include additional bells and whistles, such as the form of assignment to be used by the acquiring party in assigning the interest to the parties that exercise their option.

A sample form of a Standard AMI provision is attached in the Appendix to this Article. Consistent with the fact that AMI's are typically included in broader agreements, this AMI is not set up as a standalone agreement, although it could be fairly easily modified to constitute one. It should also be noted that this provision is offered as an illustration, and not as an ideal example, since many of the specific provisions of an AMI will be dictated by the specific circumstances of the parties' deal, including the instrument in which the AMI is contained, and/or the instrument or instruments associated with it.

17. In *Lyle Cashion Co. v. McKendrick*, 204 F.2d 609, 612 (5th Cir. 1953), the court held that although the non-acquiring party had not formally exercised its option to participate in an acquisition covered by an AMI, his intent to exercise was evidenced by the parties' actions, and in addition, that the acquiring party, by accepting the benefits of the non-acquiring party in developing the acreage, was estopped to deny that the non-acquiring party has elected to participate in the acquisition. The court quoted a rather tart observation by the trial court that: "This case portrays just another oil deal in which the party in whose name the leases are taken, after the well has been successfully brought in, would like to relieve himself of an encumbrance he was glad to use in putting the deal together."

18. Acquisition costs generally include not just the amount paid for the interest, but also "brokerage fees or commissions, costs of recording, and title curative expenses." Himebaugh, *supra* note 4, at 33. Himebaugh notes that the definition of acquisition costs should clarify whether such costs include the cost of acquiring title opinions on the property. At times, a substantial dispute can arise as to what acquisition costs consist of, for example, in *J-O'B Operating Co. v. Newmont Oil Co.*, 560 So.2d 852 (La. App. 1990), the party that acquired a sublease of an oil and gas lease from the State of Louisiana claimed part of the consideration for that acquisition was its agreement to conduct a seismic program, even though this was not expressly stated in the sublease, and that as a result of the failure of some parties to agree to participate in the seismic program, they were not entitled to share in the sublease. The court found that: (1) the agreement to conduct the seismic program was part of the consideration for the sublease and; (2) the parties that had refused to participate in the seismic program had lost their right to participate in the acquisition of the sublease. *Id.* at 858-59. The court held, "The AMI agreement does not allow an electing party the right to contest the necessity for or the extent of any consideration paid by the acquirer for a lease or other mineral interest." *Id.* at 859.

19. In *Heritage Res., Inc. v. Anschutz Corp.*, 689 S.W.2d 952, 955 (Tex. App. 1985), the court held that, where an AMI was silent on the time that a party had to respond to an offer thereunder, a reasonable time would be implied, and that what was a reasonable time would be determined based on the facts at the time the parties entered into the AMI.

20. In many cases, this proportion will be identical to the ownership of the parties in the existing oil and gas leases in the area. In other cases, for example where the AMI is included in a farmout type arrangement, the ownership will be based on the interests that will result in the farnee earning oil and gas leases, generally by drilling wells.

B. THE OVERRIDE AMI

The Override AMI presents many of the same issues as the arrangement described in the preceding section, but it also differs from that arrangement in certain key aspects. The basic characteristic of the Override AMI is that it gives one of the parties to the AMI the right to be assigned an overriding royalty in the acquired oil and gas interest. As Professors Kramer and Martin note:

Typically . . . the term overriding royalty is used to describe a royalty carved out of the working interest created by an oil and gas lease. Most frequently it is created subsequent to a lease by grant or reservation. For example, the original lessee may transfer the leasehold, or some part thereof, retaining a 1/16 overriding royalty—an override created by reservation—or the lessee may transfer a 1/16 overriding royalty for a valuable consideration—an override created by grant.²¹

Overriding royalties are a form of compensation used in various ways in the oil and gas industry. They are, for example, a very common feature of farmout agreements.²² Another way that an overriding royalty may be used is as compensation for a party that develops an oil and gas “prospect.”²³ In some cases, a party may develop a prospect but not have actually taken any leases in the prospect area; in other cases, some leases may have been acquired, but the parties anticipate acquiring additional leases. The Override AMI provides that one or more of the parties will receive the agreed-upon overriding royalty on all oil and gas leases (and perhaps other oil and gas interests) acquired in the future within the AMI.²⁴

The three critical ways that the Override AMI differs from the Standard AMI is that first, they are generally one sided; only one party has the right to acquire the overriding royalty in oil and gas interests acquired by the other party. Second, the party with the right to be assigned the overriding

21. 2 PATRICK H. MARTIN & BRUCE M. KRAMER, WILLIAMS & MEYERS, OIL & GAS LAW § 418 (2012).

22. See Lowe, *supra* note 7, at 829-32.

23. “Overriding royalty interests are frequently used to compensate the geologist who developed the prospect, the landman who took the lease, or others who performed service for the Lessee and have helped to structure a drilling venture.” Edward M. Fenk, *Are Overriding Royalty Interests Becoming the Clay Pigeons of the Texas Oil and Gas Industry? The Assignor-Assignee Relationship after Sasser v. Dantex Oil & Gas*, 5 TEX. WESLEYAN L. REV. 231, 233, n.19 (1999).

24. An Override AMI was, in fact, the type of AMI that was involved in the case that is the focus of this article, *Golden v. SM Energy Co.*, 2013 ND 17, 826 N.W.2d 610. See also *Mountain West Mines Inc. v. Cleveland-Cliffs Iron Co.*, 376 F. Supp. 2d 1298 (D. Wyo. 2005), *aff'd* in part, *reversed* in part and *remanded*, 470 F.3d 937 (10th Cir. 2006); *Grimes v. Walsh & Watts, Inc.*, 649 S.W.2d 724 (Tex. App. 1983).

royalty is not required to pay any portion of the consideration paid by the acquiring party for the interest from which the overriding royalty is to be granted. Third, because there is no obligation to pay for the overriding royalty to be granted, the AMI will usually provide that the overriding royalty is to be granted automatically; that is, there is no option to acquire as is provided for in the Standard AMI.²⁵

III. WHY IS THE AMI USED?

Typically, Standard AMIs are used to address one or both of two concerns. The first concern results from the fact that, in many cases when parties enter into an agreement for exploring and developing an area, they will not have leased all of the area in question; in fact, in some cases a large proportion of the area, or even the entire area, may be unleased.²⁶ Generally, parties will be far more willing to expend funds on a seismic survey and/or drilling exploratory wells if they know they will have the option of sharing in any acquisitions of oil and gas interests in the subject area.²⁷

Although the above concern is probably the most significant motivation for the parties agreeing to an AMI, there may be a second set of concerns that relate to the operations that the parties anticipate conducting after interests have been acquired and production has been obtained. These concerns relate to there being a non-uniform interest throughout the area of operations. They can include potential conflicts of interest among the parties in accomplishing the orderly exploitation of the area, as well as problems relating to the facilities that may serve areas having a differing ownership.²⁸

25. The AMIs involved in the cases cited in the previous footnote all had these three characteristics.

26. This may be the case, for example, where the parties are entering into an agreement to jointly conduct seismic operations on a large area.

27. “The purpose of an area of mutual interest clause is to provide that the parties jointly funding the exploration of the area will own the benefits of the exploration activities jointly and proportionately.” Zarlengo, *supra* note 5, at 839; *see also* Clovelly Oil Co. v. Midstates Petroleum Co., 112 So.3d 187, 195 (La. 2013) (“The AMI clause assures participants that the developmental opportunities in the area will be owned by them in the same percentages as the initial risk dollars are borne, preventing one of the participants from using the jointly acquired data to acquire leases in the AMI for its sole account.”). It should also be noted that, under most exploration agreements, one party will be designated as operator, and actually will conduct any seismic and/or drilling operations conducted under the terms of the agreement. Since the operator will generally have the first access to the information obtained, the other parties will be legitimately concerned that the operator will have an unfair advantage in acquiring oil and gas leases and other interests; thus, they will require an AMI to protect their ability to share in such acquisitions.

28. *See* Cross, *supra* note 2, at 220 (“Smooth operation of an AMI over any length of time requires a ‘maintenance of uniform interest’ provision to be in place.”). These are basically the

The concerns that motivate the Override AMI are similar to the first set of concerns described above. Basically, a party that develops a prospect will want to insure that it receives its override on all of the leases that are eventually taken in the prospect, not just those that are in existence at the time the deal is entered into. Indeed, in those cases where a party has developed a prospect, but no leases have been taken, the Override AMI is the only way that party will receive its compensation.

IV. GENERAL REQUIREMENT FOR VALIDITY

Since an AMI is an instrument that creates rights in real property it is subject to the rules which the law imposes for such instruments to be valid. This section will discuss two of those requirements: first, compliance with the statute of frauds, and second, compliance with the rule against perpetuities. Two issues that will not be discussed in detail concerning the validity of AMIs are whether they constitute an unreasonable restraint on alienation or an unreasonable restraint on trade. As Dante Zarlengo concluded in his early article on AMIs generally used in the oil and gas industry, they should not constitute either an unreasonable restraint on alienation or an unreasonable restraint on trade.²⁹

A. STATUTE OF FRAUDS

Since an AMI is an agreement to transfer an interest in real property, it will generally be subject to the statute of frauds applicable in the state where the property is located.³⁰ Compliance with the statute of frauds requires that the description of the land covered “must be such that would enable a competent surveyor to find the land in question from the

same concerns that underlie the inclusion in JOAs of a “Maintenance of Uniform Interest Clause,” under which a part may only sell its interest in the area covered by the JOA if such sale covers: “1. the entire interest of the party in all Oil and Gas Leases, Oil and Gas Interests, wells, equipment and production; or 2. an equal undivided percent of the party’s present interest in all Oil and Gas Leases, Oil and Gas Interests, wells, equipment and production in the Contract Area.” Am. Ass’n of Petroleum Landmen, *supra* note 11, at 15. As one authority has noted,

The requirement of uniformity is imposed to insure both administrative efficiency and viability of the overall scheme of joint operations. Unless the fractional interest of the parties remains uniform, as initially established in the provisions of the operating agreement, the operator will be confronted with an increasingly complex pattern of ownership which varies by geographic area.

Conine, *supra* note 7, at 1327.

29. Zarlengo, *supra* note 5, at 851-55.

30. *See, e.g.*, N.D. CENT. CODE § 9-06-04 (2013) (“The following contracts are invalid, unless the same or some note or memorandum thereof is in writing and subscribed by the party to be charged, or by the party’s agent: . . . 3. An agreement for the leasing for a longer period than one year, or for the sale, of real property, or of an interest therein.”).

memorandum or from references made in the memorandum.”³¹ As a general rule, “the description is sufficient if the reference to the property in the deed is such that the court, by pursuing an inquiry based upon the words of reference, is able to identify the particular property to the exclusion of all other property.”³² Parole evidence may not be introduced to supplement the description of property covered by an AMI.³³ The Texas case of *Westland Oil Development Corporation v. Gulf Oil Corporation*³⁴ provides useful examples of what descriptions will and will not be sufficient under the statute of frauds. The instrument in that case contained two descriptions of land. The first referred to leases affecting the lands covered by a farmout. The farmout itself described specific sections of land, and the court found that this description was sufficient to meet the requirements of the statute of frauds.³⁵ However, the court found that the second description, which referred to “lands within the area of the farmout acreage,” was not sufficient, noting: “[w]hen resort to extrinsic evidence is proper, it should be used only for the purpose of identifying the land with reasonable certainty from the data in the memorandum, and not for the purpose of supplying its location or description.”³⁶

Of course, the very nature of AMIs mean that they do not describe specific tracts of land that are being conveyed or are going to be conveyed. Instead, they describe an area within which a portion of an interest in a tract or tracts of land will be required to be conveyed in the future if a party to the AMI acquires an interest therein. I am not aware of any cases in which a party to an AMI attempted to claim that it did not satisfy the statute of frauds on the grounds that it did not describe the specific acreage or leases to be conveyed. It does appear, however, that this type of argument was made in the Texas case of *Long v. Rim Operating, Incorporated*,³⁷ with regard to a provision in a joint operating agreement that required that a party that did not participate in an operation that was required to maintain a

31. *Klipfel v. Brandenburger*, 156 N.W.2d 774, 777 (N.D. 1968). See also *Crowder v. Tri-C Res., Inc.*, 821 S.W.2d 393, 396 (Tex. App. 1991) (“No part of the memorandum is more essential than the description of the land.”).

32. *First Sec. Bank v. Enyart*, 439 N.W.2d 801, 807 (N.D. 1989), (quoting *State v. Rosenquist*, 51 N.W. 767, 778 (N.D. 1952)).

33. See *Crowder*, 821 S.W.2d at 396 (The memorandum “must be complete within itself in every material detail and contain all of the essential elements of the agreement so that the contract can be ascertained from the writings without resorting to oral testimony.”). Parole evidence is also generally not admissible to prove the other terms of an AMI. See, e.g., *Petrocana, Inc. v. Margo, Inc.*, 577 So. 2d 274, 278 (La. Ct. App. 1991) (Parole evidence not admissible to show agreement of the parties to extend an AMI beyond the period provided for in the writing).

34. 637 S.W.2d 903 (Tex. 1982).

35. *Westland Oil*, 637 S.W.2d at 909.

36. *Id.* at 910.

37. 345 S.W.3d 79 (Tex. App. 2011).

lease relinquish all of its interest in that lease to the parties that conducted the operation. The court agreed that, at the time the operating agreement was executed, the parties did not know the lease or leases to which this requirement would be applied. But, citing *Westland*, the court held that since the application of the provision in question was limited to the area covered by the JOA, that description was sufficient.³⁸ Since *Westland* did involve an AMI, the court's citation of that case suggests it would also find that the fact an AMI did not describe specific tracts of land to be conveyed would not be sufficient to invalidate the AMI under the statute of frauds.

The requirement for an adequate description of the property covered by an AMI can, however, sometimes lead to problems. Because the parties are generally attempting to describe a broad area that may be of interest, based on the results of their exploration activities, they often will not feel that great precision in the description of the area is required.³⁹ As one authority, describing AMI agreements used in North Dakota indicated: “[t]he A.M.I. is identified by a map or plat attached as an exhibit clearly indicating the outline of the area.”⁴⁰ As another authority has noted, however:

Often, these maps do not contain field notes or metes and bounds descriptions or even legible names of leagues, labors or surveys which would enable one to locate these areas on the ground by survey. In many cases, such practice renders these agreements unenforceable because of failure to comply with the statute of frauds.⁴¹

As the case of *Palmer v. Fuqua*⁴² illustrates, some courts have been willing to avoid invalidating an AMI under the statute of frauds, even though a strict application of the law would likely require them to do so. *Fuqua* involved a limited partnership that was formed to acquire oil and gas leases. The partnership agreement provided that “any property or properties acquired in the area of interest owned by this Partnership shall first be offered to the Limited Partner”⁴³ Noting that, while the “farthest

38. *Id.* at 89.

39. The case of *Lyle Cashion Co. v. McKendrick*, 204 F.2d 609, 612 (5th Cir. 1953) provides an example of how large an AMI may be. In that case, the covered interests acquired were “within a radius of ten (10) miles of the well site” for the initial well drilled under the agreement between the parties. Although not a precise description of boundaries by sections or metes and bounds, this does describe an area that could be ascertained by a survey on the ground. Presumably, this would be sufficient to meet the requirements of the statute of frauds.

40. Himebaugh, *supra* note 4, at 32. See also *Crowder v. Tri-C Res., Inc.*, 821 S.W.2d 393, 395 (Tex. App. 1991); *J-O’B Operating Co. v. Newmont Oil Co.*, 560 So.2d 852, 853 (La. Ct. App. 1990) (both cases refer to an AMI that was outlined in red on a plat).

41. Thanheiser, *supra* note 5, at 7.

42. 641 F.2d 1146 (5th Cir. 1981).

43. *Palmer*, 641 F.2d at 1149.

reaches” of this description might not be clear, the court held that “at the very least, the area of interest includes properties contiguous to lands owned by the partnership.”⁴⁴ Responding to the argument that the agreement violated the statute of frauds, the court acknowledged that the statute of frauds applied to oil and gas leases, assignments of leases, options to acquire leases and contracts to assign and sell leases.⁴⁵ The court found, however, that the statute did not apply to the agreement before it, stating that the agreement, “was simply a statement of fiduciary obligation in a partnership agreement[.]”⁴⁶ and that the operative language of the agreement specified “requires a partner to make an offer under certain circumstances—it is not the offer itself.”⁴⁷

One authority has disagreed with the result in *Fuqua*, arguing that the statute of frauds should generally be applicable to AMIs:

It does not impose a great burden on the parties to require them to give a specific description of the areas to be covered by the mutual interest clause. The public policy to be served by requiring a definite statement of the duties and obligations of the parties and, even more importantly, of their successors in interest, certainly out-weighs the desirability of enforcing an indefinite area of mutual interest clause. If the area of mutual interest clause is not enforceable, the court may resort to other remedies in order to accomplish a just end. To distort the terms of the area of mutual interest clause and unnecessarily weaken the Statute of Frauds in accomplishing these ends is far less desirable.⁴⁸

Whether one accepts this argument, it is certainly the case that, for attorneys involved in drafting AMIs, the effort involved in ensuring that it contains an accurate description is minor compared to the cost and risk of

44. *Id.* at 1154.

45. *Id.* at 1158.

46. *Id.*

47. *Id.* at 1158-59. The court also based its ruling on the fact that the statute of frauds generally did not apply to partnerships or joint ventures in which the subject matter is land, and that the action before it was not an action to enforce the AMI, but rather was “an action to impress a constructive trust upon property as a remedy for the breach of a fiduciary obligation. The imposition of a constructive trust is not prevented by the Statute of Frauds.” *Id.* at 1159.

48. Zarlengo, *supra* note 5, at 845. Discussing *Fuqua*, Zarlengo noted that:

[T]he courts have been somewhat more willing to enforce provisions contained in partnership agreements having the same practical effect as an area of mutual interest clause, and notwithstanding the fact that some exploration agreements might be considered for many purposes to be partnerships with respect to the fiduciary and related obligations of the parties.

Id. at n.10.

incurring litigation over whether the description meets the requirements of the statute of frauds.

B. RULE AGAINST PERPETUITIES

The Rule Against Perpetuities, under North Dakota law, states: “A contingent property interest is invalid unless: (a) When the interest is created, it is certain to vest or terminate no later than twenty-one years after the death of an individual then alive; or (b) The interest either vests or terminates within ninety years after its creation.”⁴⁹ The rule has been held applicable to oil and gas leases,⁵⁰ and it is reasonably clear that, technically, it would also apply to AMIs.⁵¹ However, as I observed more than a decade ago:

It should be noted that as a general rule, if perpetuities issues arise with regard to an AMI, it will be the result of a mistake in drafting . . . [P]arties generally enter into an AMI in order to facilitate the orderly operation of a particular area during the exploration period of the applicable agreement, and will not wish to bind themselves to share an acquired interest beyond that period. It would be unusual for this term to exceed the base twenty-one year period provided for in the rule against perpetuities.⁵²

Of course, in the oil and gas industry, as in all areas of the law, mistakes in drafting will occur. In some cases, parties may simply forget to include a term for the AMI, raising perpetuities issues.⁵³ In addition, if the term of the AMI is tied, for example, to the term of an operating agreement, a perpetuities issue may be created since operating agreements generally provide that they will be in effect either for the life of the leases covered thereby or for so long as there is production from or operations on the land

49. N.D. CENT. CODE § 47-02-27.1(a)-(b) (2013).

50. *See* Nantt v. Puckett Energy Co., 382 N.W.2d 655, 659-60 (N.D. 1986).

51. *See* Conine, *supra* note 7, at 1376 (“the area of mutual interest clause . . . seek[s] to assure the conveyance of interests at a point in the future which may exceed the limitations prescribed in the rule [against perpetuities].”).

52. Lansdown, *supra* note 5, at 5-6. *See also* Cross, *supra* note 2, at 220, noting:

In most instances, AMIs serve their purpose if they have a term of five to eight years.

Even if no leases are owned initially, this length of term allows for the acquisition of seismic options, the exercise of the options, primary terms in leases of at least three years, plus a generous cushion for renewals and extensions of those leases.

53. It appears likely that this is what occurred in *First Nat’l Bank & Trust Co. v. Sidwell Corp.*, 678 P.2d 118 (Kan. 1984), and *Courseview, Inc. v. Phillips Petroleum Co.*, 258 S.W.2d 391 (Tex. App. 1953).

covered by the agreement.⁵⁴ In either case, this can extend beyond the perpetuities period.

It should also be noted, however, that in the context of oil and gas instruments, including AMIs, “there appears to be a trend to relax the inflexible application of the rule and to give effect to the intent of the parties.”⁵⁵ One way that this has been accomplished is demonstrated in *First National Bank & Trust Company v. Sidwell Corporation*,⁵⁶ where the court rejected the argument that the rule applied to invalidate an AMI, holding, “[t]he [AMI] did not involve the vesting of future interests in real property and did not constitute a restraint upon the alienation of that property. The rule against perpetuities does not apply to the purely contractual obligations involved here.”⁵⁷

Although it does not appear that courts in North Dakota have had occasion to review the applicability of the rule against perpetuities to AMIs, in *Nantt v. Puckett Energy Company*,⁵⁸ the court rejected a challenge to a group of top leases based on the rule. A “top lease” is “[a] lease granted by a landowner during the existence of a recorded mineral lease which is to become effective if and when the existing lease expires or is terminated.”⁵⁹ In *Nantt*, the top leases required that once the underlying leases expired, the lessee was required to pay an additional consideration for the top leases to become effective, and the lessee had issued drafts for the second payment.⁶⁰ Since an oil and gas lease typically provides that it will be effective for so long as there is production from the leased premises, it is clear that the underlying lease may remain in effect beyond the perpetuities period, and that the top lease may therefore become effective beyond that period. The court in *Nantt*, however, rejected the argument that the top leases were invalid under the rule against perpetuities, accepting the trial court’s

54. See, e.g., Am. Ass’n of Petroleum Landmen Form 610-1989 Model Form Operating Agreement, art. XIII.

55. Conine, *supra* note 7, at 1376.

56. 678 P.2d 118 (Kan. 1984).

57. *First Nat’l Bank & Trust Co.*, 678 P.2d at 126-27. In *Producers Oil Co. v. Gore*, 610 P.2d 772 (Okla. 1980), the court found that the rule was not applicable to a right of first refusal contained in an operating agreement. The court initially noted that the rule would not apply if the rights created under the preemptive provisions were merely contractual, but held that, since rights were created with regard to oil and gas leases, which were interests in real property, the rule had to be considered. *Id.* at 774. However, the court went on to hold that right of first refusal did not violate the rule, since it was limited by the terms of the operating agreement, which, in turn was limited by the term of the lease. *Id.* at 775-76. It should be noted, however, that this specific reasoning would not apply to AMIs, since they provide a right to acquire interests in future leases and thus would not be limited by the terms of an existing lease.

58. 382 N.W.2d 655 (N.D. 1986).

59. WILLIAMS & MEYERS MANUAL OF OIL & GAS TERMS, *supra* note 1, at 1073.

60. 382 N.W.2d at 657.

determination that “the options for the top leases . . . were exercised by the immediate issuance and delivery of the second drafts for the additional bonus, conditioned only upon ‘approval and acceptance of titles’ i.e. expiration of the underlying leases . . . without extension by drilling or production.”⁶¹ The court’s reasoning on this issue is unclear. If, in fact, the top leases were “conditioned” upon acceptance of title, which consisted of the expiration of the underlying leases and such underlying leases could be in effect beyond the expiration of the primary term, why was the rule of perpetuities not applicable? In any event, *Nantt* suggests, like the Kansas court in *Sidwell*, that North Dakota courts will be sympathetic to arguments that seek to avoid the application of the rule against perpetuities to AMIs.

V. IS THE AMI BINDING ON SUCCESSORS AND ASSIGNS?

In order to fully understand the nature of the question of whether an AMI is binding upon successors and assigns, it is initially necessary to address the question: successors and assigns to what? Broadly speaking there are two answers to this question: (1) successors and assigns to the AMI agreement itself; and (2) successors and assigns to some agreement and/or interest that is related in some way to the AMI. Generally speaking, the answer in the first situation is, if an AMI, or the agreement containing an AMI is assigned, it will be binding upon the assignee, unless the agreement contains an express provision to the contrary, since the very nature of an assignment of an agreement is that a party assumes all of the rights and obligations thereunder.⁶²

The second type of situation could arise as follows: Company A and Company B enter into an Exploration Agreement that includes an AMI. Company A acquires leases on a substantial block of acreage that is located within the AMI which, pursuant to the terms of the AMI, it shares with Company B. Subsequently, Company B conveys its entire interest in the leases to Company C, but does not purport to assign its rights and obligations under the Exploration Agreement. Thereafter, Company C acquires leases on unleased acreage located within the AMI. Company A claims that, under the terms of the AMI, Company C is obligated to offer Company A its proportionate part of the leases under the terms of the AMI.

61. *Id.* at 661. The court noted a constructional preference against the application of the rule, and cited, as a second basis for its conclusion the “wait and see” or “second look” approach to perpetuities cases, noting that while the approach “is still evolving and is not yet a prevailing rule, it is a basic common sense approach to ‘perpetuities’ today.” *Id.*

62. The parties to an exploration agreement could certainly provide that the AMI portion of the agreement is not binding upon successors and assigns, possibly to make the agreement more “assignable” to parties that were interested in the prospect covered by the agreement, but did not want to be bound by an AMI; however, I have never encountered this.

Thus, the question remains whether the terms of the AMI are binding upon Company C by virtue of its acquisition of leases from Company B.

Before addressing the legal aspects of this question, a word of warning is probably appropriate. Cases involving this issue are virtually always far more involved and complex than the situation described above. There are various reasons for this, but two significant factors include: (1) the cases often involve a large number of parties and a correspondingly large number of transactions; and (2) the cases often involve arrangements that are more complex. Perhaps the best example of this is the case most often cited with regard to AMIs, *Westland Oil*,⁶³ which involved multiple letter agreements, farmouts, assignments and at least one operating agreement.⁶⁴ Rather than attempt to describe these arrangements and their interaction, I will refer to Angus Earl McSwain's article on the case, which contains detailed charts of the various agreements and their interactions.⁶⁵

While *Westland* may represent the "outer edge" of complexity that is involved in cases concerning AMIs, it is fair to say that most cases involving AMIs, and particularly the question of whether an AMI is binding upon successors, are far from simple. Probably the simplest cases involve Override AMIs; other cases are likely to be more complex. When discussing these cases, I will do my best to provide a description of the facts that are accurate but also simple enough to enable the reader to understand the case's significance with regard to the issues discussed.

A. THE NOTICE REQUIREMENT

As is the case with any instrument affecting real property, the question of whether an AMI is binding upon a successor in interest will initially depend upon whether the successor has actual or constructive notice thereof. Initially, it should be noted that the AMI will be binding upon the parties thereto, and parties who have actual notice thereof, even if it is not recorded.⁶⁶ However, if it is not properly recorded, an AMI would not be valid against a subsequent purchaser who took without actual notice.⁶⁷

One interesting aspect of issues concerning oil and gas title is, while parties have always been careful to insure that some instruments, such as leases and pooling agreements, are properly placed of record, for many years they tended to be less diligent about the recordation of other

63. 637 S.W.2d 903 (Tex. 1982).

64. *Westland Oil Dev. Corp.*, 637 S.W.2d at 904-06.

65. Angus Earl McSwain, *Westland Oil Development Corp. v. Gulf Oil: New Uncertainties as to Scope of Title Search*, 35 BAYLOR L. REV. 629, 629-33 (1983).

66. N.D. CENT. CODE § 47-19-46 (2013).

67. *Id.*

instruments, such as operating agreements, farmouts, and similar arrangements.⁶⁸ As one authority has noted: “[i]t is rare indeed for an AMI to be contained in a recorded agreement, and therefore they can easily be missed by someone in a hurry to buy and sell leases or to drill a well.”⁶⁹ This can raise the question of whether a reference to an unrecorded AMI in a recorded instrument is sufficient to place parties on notice of the existence of the AMI. In Texas, this question was firmly answered in the affirmative in the case of *Westland*, in which the court held that parties were charged with notice of an AMI contained in a letter agreement that was referenced in an operating agreement to which a recorded assignment was recited to be subject.⁷⁰ The dissent in *Westland* disagreed and argued that parties could not properly be charged with notice of the AMI in that situation, given that the reference in the recorded assignment was to an operating agreement, noting:

[T]he function of an operating agreement is to explain in detail the operation between the various interests in the development of a tract for economical production of the minerals, not to establish interests of any kind. Therefore, a reference to any conflict with an operating agreement might well have alerted a reasonably diligent purchaser to check the letter agreement if he was concerned with the operations, not for title reasons.⁷¹

It is probably fair to say that *Westland* represented a fairly “absolutist” position on parties being charged notice. As Angus Earl McSwain ably summarized the question faced by the *Westland* court:

The important issue faced by the court dealt with the title search required of the vendee. There are basically two choices: (1) he must investigate *every* reference to *every* instrument; or (2) he is only bound to investigate those matters which reasonably appear to be title-related.⁷²

As indicated in *Westland*, the Texas Supreme Court adopted the first of these approaches. McSwain basically agreed with the dissent in the case,

68. See J. Robert Goldsmith, *An Overview of Bankruptcy and Creditor's Rights in Relation to the Texas Oil and Gas Industry*, Advanced Oil Gas & Min. L. Course K-13 (1986) (“Most operating agreements are never recorded and, in fact, cannot be recorded because they lack acknowledgments.”). More recently, parties have become more diligent about obtaining the protection of the recordation statutes. For example, the 1989 version of the AAPL Operating Agreement is the first to include a memorandum that can be placed of record.

69. Cummings, *supra* note 5, at 5-6.

70. 637 S.W.2d 903, 908 (Tex. 1982).

71. *Id.* at 912 (Wallace, J. dissenting).

72. McSwain, *supra* note 65, at 642 (emphasis in original).

observing that, although the cases cited by the Supreme Court support the proposition that the purchaser is bound by references contained in documents in the chain of title. “In all of those cases, however, the references are clearly to title-related documents concerning a title related matter.”⁷³

It should be noted that, whether one agrees with the dissent in *Westland* and *McSwain*, one advantage of the majority’s approach is that it will generally make it easy for parties to answer questions about notice, rather than having to do an intensely factual analysis of whether it was reasonable to charge parties with notice in a particular situation. *McSwain* himself acknowledged that the approach he favored would involve a detailed factual analysis in which general principles may be of limited value.⁷⁴ This substantially increases the likelihood that parties will engage in extended, and likely burdensome and expensive, litigation over whether the documentation in their case provided sufficient notice.

North Dakota does follow the rule that “[o]ne who has knowledge of the facts sufficient to put a prudent person upon inquiry with regard to the existence of an unrecorded deed, and fails to make such inquiry, cannot claim protection as a bona fide purchaser under the recording act.”⁷⁵ There does not, however, appear to be any North Dakota cases similar to *Westland* that address what in a recorded document would constitute sufficient notice of an unrecorded AMI. Future cases will thus determine whether North Dakota moves towards the absolutist approach of the *Westland* majority or the case-by-case analysis advocated by *McSwain* and the *Westland* dissent.

B. IS THE AMI A COVENANT THAT BINDS SUCCESSORS AND ASSIGNS?

An AMI may be binding upon a successor or assign in two ways: first, if it is deemed to be a covenant running with the land, and second, if the successor or assign agrees to be bound. As will be discussed below, it appears that some authorities actually consider the question of whether the AMI is deemed to be a covenant running with the land to be dispositive of the question of whether it is binding upon successors. However, as the *Golden* case makes clear, this is not correct.

73. *Id.* at 653.

74. *Id.* at 645.

75. *Burlington N., Inc. v. Hall*, 322 N.W.2d 233, 238 (N.D. 1982).

1. *Is the AMI a Covenant that Runs with the Land?*

In order for an obligation to be a covenant “running with the land,” there must be privity of estate between the assignor and the assignee and the obligation imposed by the AMI must “touch and concern” the land.⁷⁶ The “touch and concern” requirement originated in England in *Spencer’s Case*, in which the court stated “if the thing to be done be merely collateral to the land and doth not touch or concern the Thing demised in any sort, there the assignee shall not be charged.”⁷⁷

The concept of running with the land is actually contained in the North Dakota statutes:

Certain covenants contained in grants of estates in real property are appurtenant to such estates and pass with them so as to bind the assigns of the covenantor and to vest in the assigns of the covenantee in the same manner as if they personally had entered into them. Such covenants are said to run with the land.⁷⁸

What is more, the statute provides that the only covenants that run with the land are those that the statute specifies, along with covenants that are incidental thereto;⁷⁹ those are the covenants that are “for the direct benefit of the property or some part of it then in existence, run with the land.”⁸⁰

Although it did not involve an AMI covering oil and gas properties, *Beeter v. Sawyer Disposal*⁸¹ provides insight on the question of whether such an AMI would be considered a covenant running with the land in North Dakota. That case involved a parcel of property that was conveyed for use as a municipal landfill. The grantee agreed to pay the grantor six percent of the revenue derived from any expansion or extension of its operations; thus, the arrangement was similar to an Override AMI. The property was subsequently conveyed and the original grantor claimed that the subsequent grantee was obligated to continue to make the six percent payment. The trial court had held that the agreement to pay the six percent was not a covenant running with the land, but it was nevertheless binding upon the subsequent grantee based on the parties’ intent.⁸²

76. Cross, *supra* note 2, at 218.

77. (1583) 77 Eng. Rep. 72 (K. B.) 74.

78. N.D. CENT. CODE § 47-04-24 (2013).

79. *Id.* § 47-04-25.

80. *Id.* § 47-04-26. Those covenants include the covenant of warranty, the covenant for quiet enjoyment, the covenant for further assurances on the part of the grantor and the covenant for the payment of rent taxes or assessments upon the land on the part of the grantee. *Id.*

81. 2009 ND 153, 771 N.W.2d 282.

82. *Beeter*, 2009 ND 153, ¶ 7, 771 N.W.2d at 285.

The North Dakota Supreme Court reversed the holding of the trial court. Initially, the court agreed with the conclusion of the trial court that the covenant in question did not run with the land, noting that if the covenant did not directly benefit the land as required by the statute, it was personal and enforceable only between the original parties to the deed. Further, the court noted that it was generally recognized that a covenant to pay for land in a particular way is personal.⁸³ The court then stated:

The covenant in the deed in this case requiring payment of six percent of gross revenues from waste disposal operations does not in any manner benefit the land. It is a purely personal benefit . . . and appears, in fact, to be part of the consideration and payment for the land.⁸⁴

The court went on to reject the trial court's conclusion that the covenant was nevertheless binding upon the subsequent grantee, stating that the intent of the parties "no matter how clearly expressed, does not make the covenant binding upon subsequent purchasers."⁸⁵

In *Westland Oil*, the Texas Supreme Court clearly held that the AMI in that case did run with the land.⁸⁶ The court initially noted that for a covenant to run with the land, there must be privity of estate between the parties, meaning that there must be "a mutual or successive relationship to the same rights of property" which the court found existed in that case because of the assignment of leasehold.⁸⁷ The court further held that the AMI touched and concerned the land, and after acknowledging that the tests for making this determination "are far from absolute", the court held that "the promise to convey the prescribed interests in the leases [covered by the AMI agreement] clearly affected the nature and value of the estate conveyed It burdened the promisor's estate and could be considered to have rendered it less valuable."⁸⁸ Thus, the court concluded that the obligations imposed by the AMI did run with the land.

The *Westland* case was criticized in a thorough Baylor Law Review note written by Angus Earl McSwain.⁸⁹ McSwain began by acknowledging that the issue of covenants running with the land was a difficult one, noting that decisions on the issue "often state the general rule and conclude that the

83. *Id.* ¶ 10, 771 N.W.2d at 286.

84. *Id.* ¶ 13, 771 N.W.2d at 287.

85. *Id.*

86. 637 S.W.2d 803 (Tex. 1982).

87. *Id.* at 910-11.

88. *Id.* at 911.

89. McSwain, *supra* note 65, at 629. As noted in Section V(A), McSwain also criticized the *Westland* court's holding with regard to notice. *Id.* at 643.

covenant either does or does not meet the requirement. These decisions do not often explain the application of the general statements to the facts at hand, rather, their arguments beg the question”⁹⁰ The basic question, McSwain concluded, was whether the legal interest in the land of the promisor was made more or less valuable by the performance of the promise.⁹¹ He contended the AMI did not touch and concern the land involved in *Westland* because the primary effect of an AMI “is to require the conveyance of *other* lands.”⁹²

Grimes v. Walsh and Watts, Incorporated,⁹³ a Texas Court of Appeals case that was decided the year after *Westland*, suggests at least one limitation that Texas courts might impose on the *Westland* holding. In *Grimes*, the court held that an AMI between an assignor and assignee of a farmout was not binding upon a subsequent assignee of an interest in the farmout where the lease that was originally subject to the farmout had expired and the subsequent assignee took a new lease from the lessor. The court agreed with the trial court that the AMI was a personal covenant between the parties and not a covenant running with the land.⁹⁴ The court distinguished *Westland*, noting that unlike in *Westland*, in the case before it there was not a “mutual or successive relationship” as to the property in question, since the original lease had terminated.⁹⁵ It should be noted that the AMI involved in *Grimes* was an Override AMI, but that did not appear to be a factor in the court’s decision.

A similar result was reached in *Mountain West Mines Incorporated v. Cleveland-Cliffs Iron Company*,⁹⁶ a federal case in Wyoming that involved an Override AMI under which Mountain West Mines (“Mountain West”) was to receive an overriding royalty interest in any uranium properties that were acquired by Cleveland-Cliffs Iron Co. (“Cleveland-Cliffs”) in an area described as the Powder River Basin.⁹⁷ Cleveland-Cliffs had acquired certain properties, and later conveyed them to other parties (the “Assignees”).⁹⁸ Mountain West claimed that, under the AMI, it was entitled to be assigned its override in any properties subsequently acquired

90. *Id.* at 636.

91. *Id.* at 637.

92. *Id.* at 641 (emphasis in original).

93. 649 S.W.2d 724, 728 (Tex. App. 1983).

94. *Id.* at 726, 728.

95. *Id.* at 728.

96. 376 F. Supp. 2d 1298 (D. Wyo. 2005), *aff’d in part, rev’d in part, and remanded*, 470 F.3d 947 (10th Cir. 2006).

97. *Mountain West*, 376 F. Supp. 2d at 1300.

98. *Id.* at 1300-01.

by the Assignees.⁹⁹ The district court rejected this argument, holding that the AMI was not a covenant running with the land. The court distinguished *Westland* on the grounds that, in that case, “the original parties to the agreement had an interest in the land when the covenant was made, and the subsequent party obtained an interest in *that land* subject to the covenant from one of the original parties.”¹⁰⁰ The court also found that it was not the intent of the parties that the AMI burden successors in interest.¹⁰¹ Again, the fact that the AMI in that case was an Override AMI did not appear to be a direct factor in the court’s decision.

It is also worth noting that the mere fact that an AMI is deemed to be a covenant running with the land does not necessarily mean that it will be binding upon an assignee of an interest covered by the AMI. In *Rio Gas Company v. MidCon Gas Services Corporation*,¹⁰² Stallion Oil Co. (“Stallion”) was a party to three separate participation agreements with: (1) Rio Gas Company (“Rio”); (2) MidCon Gas Services Corp. (“MidCon”); and (3) H.H. McJunkin, Jr. (“McJunkin”).¹⁰³ At issue was whether MidCon was bound by an AMI in the Stallion/Rio and Stallion/McJunkin agreements, even though it was not a party to those agreements by virtue of the fact that it was assigned certain leases by Stallion under the Stallion/MidCon agreement.¹⁰⁴ The court expressly acknowledged that the AMI in the Stallion/Rio and Stallion/McJunkin agreements might have been a covenant running with the land, but held that under the terms of the agreements, MidCon was not bound by the AMI as an assignee of leases that were subject to those agreements, since it was not an “assign” for the purposes of the AMI clause.¹⁰⁵

2. *Golden v. SM Energy Company, and the Question of Whether a Successor or Assign Otherwise Agreed to be Bound*

Even if the AMI is a personal covenant that does not run with the land, this does not fully answer the question of whether it will be binding upon successors and assigns. In addressing this question, I believe it is initially necessary to address some potential confusion created by the fact that, in addressing the question of whether an AMI is binding upon successors,

99. *Id.* at 1301.

100. *Id.* at 1307.

101. *Id.* at 1308. The Court of Appeals upheld the District Court, focusing primarily on its conclusion that it was not the intent of the parties that the AMI burden successors in interest. *Mountain West*, 470 F.2d at 951-52.

102. 1999 WL 333152 (Tex. App. May 27, 1999).

103. *Rio Gas Co.*, 1999 WL 333152, at *1.

104. *Id.*

105. *Id.* at *6.

many authorities focus solely on the question of whether the AMI is a covenant that runs with the land. In fact, they often state the question of whether the AMI is binding upon successors in interest as being entirely dependent upon whether the AMI is a covenant that runs with the land. For example, Terry Cross, in his excellent article on the various restrictions on alienation that may burden oil and gas properties, states “an AMI is of limited value if a party can transfer its ownership position in an area free and clear of the AMI obligations, so most AMIs expressly extend to ‘successors and assigns.’ However, in order to actually bind successors, a covenant must actually ‘run with the land.’”¹⁰⁶

I would submit, however, that this is not a correct statement of the law, or at least that it is not complete. In fact, an AMI will be binding upon successor and assigns if it is a covenant running with the land, but also, if the successors or assigns, either expressly or by implication, assume the rights and obligations of the AMI. Clearly there is nothing that precludes a party from agreeing to be bound by the terms of an AMI in the same way that a party can agree to be bound by any other contractual terms.

Some of the confusion around this issue may be created by the rule that the intent of the parties to a covenant is not sufficient to change such covenant from a personal one to one that runs with the land. For example, in *Beeter v. Sawyer Disposal*, discussed above, the North Dakota Supreme Court stated:

The essence of the district court’s holding is that, regardless of the label placed upon the six-percent provision, the original parties’ intent will be controlling on the question of whether the covenant is binding on subsequent purchasers. This conclusion is in direct contradiction to the settled principle that the parties’ intent, no matter how clearly expressed, cannot make a personal covenant run with the land and bind subsequent purchasers.¹⁰⁷

The above statement of the law is correct. In determining whether a covenant contained in an agreement involving real property will be binding upon successor owners in that property, the fact that the parties to the

106. Cross, *supra* note 2, at 218. See also Thanheiser, *supra* note 5, at 10 (“In order for [an AMI] to attach to a transfer of the leases, the AMI obligation must be considered a covenant running with the land and not a covenant that is personal in nature.”). Indeed, in a prior paper on AMIs, the author himself stated, “As a general rule, in order to binding on the successors and assigns of the parties thereto, an AMI must be deemed to be a covenant with the land.” Lansdown, *supra* note 5, at 8.

107. 2009 ND 153, ¶ 12, 771 N.W.2d 282, 286. See also *Mountain West Mines, Inc. v. Cleveland-Cliffs Iron Co.*, 376 F. Supp. 2d 1298, 1305 (D. Wyo. 2005); *Lingle Water Users’ Ass’n v. Occidental Bldg. & Loan Ass’n*, 297 P. 385, 389 (Wyo. 1931) (“the intention of the original parties to a contract alone cannot create a covenant running with the land . . .”).

original agreement may have intended it to be binding upon successors does not make the covenant one that will run with the land, or otherwise make it binding upon successor in interest. This does not mean, however, that such successors cannot agree to be bound by such a covenant. In that case, it is the intent *of the successors* to be bound that will be determinative, not the intent of the original parties to the agreement.

Slawson Exploration Company v. Vintage Petroleum Incorporated,¹⁰⁸ a federal Court of Appeals case construing Kansas law, involved a participation agreement that included an AMI between Slawson and Oryx Energy Company. Slawson drilled a well pursuant to the agreement, and later sold its interest in the well to Vintage by a conveyance that recited that it covered the leases upon which the well was located and all rights in any agreements “in any way related thereto.”¹⁰⁹ Oryx recompleted the well,¹¹⁰ and acquired additional leases to cover the larger spacing unit that was established for the recompleted well. Slawson filed suit, claiming that it, not Vintage, was entitled to participate in the additional leases. The court found that, since Slawson’s rights under the participation agreement were related to the well, Slawson had assigned those rights to Vintage.¹¹¹ The court in *Slawson* did not even mention the question of whether the AMI under the participation agreement was a covenant running with the land, making it clear that Slawson and Vintage could agree that the rights and obligations of the AMI were conveyed to Vintage when Slawson conveyed its interest in the well.

Similarly, in *Wuellner Oil and Gas, Incorporated v. EnCana Oil & Gas Incorporated*,¹¹² the court was faced with a claim by Wuellner against EnCana, under an Override AMI, that Wuellner was entitled to its override under certain oil and gas leases taken by EnCana after the original party to the Override AMI had assigned its interest in oil and gas leases covered by the AMI to EnCana. In its first opinion, the court noted that the oil and gas leases that were assigned were “real rights” and that “[o]bligations

108. 78 F.3d 1479 (10th Cir. 1996).

109. *Id.* at 1481.

110. Although the opinion does not expressly state this, it appears that Oryx took over operation of the well from Slawson, and that the interest conveyed by Slawson to Vintage was therefore a non-operating interest.

111. The court rejected an argument by Slawson that language in Exhibit A to its assignment to Vintage, restricting the assignment to the existing spacing unit for the well, indicated an intent to exclude the participation agreement from the assignment. It noted that although the language in Exhibit A rendered the language in the Assignment ambiguous, it could nevertheless conclude that the intent of the parties was that Slawson’s participation rights be conveyed to Vintage. *Id.* at 1482-83.

112. 2013 WL 1289047 (W.D. La. Mar. 26, 2013), *clarifying the opinion in* 861 F. Supp. 2d 775 (W.D. La. 2012).

correlative and incidental to real rights are ‘real obligations’ and they pass automatically to the successor to the real right to which they are correlative.”¹¹³ However, the court further held that personal obligations that related to real rights did not run with the assignment of the real right, and that the obligation to assign overrides in future leases was a personal right.¹¹⁴ The court went on to hold that the language of the assignment to EnCana was unambiguous and that it did not provide for EnCana to assume any obligations that were not transferred in the assignment.¹¹⁵ Thus, the court clearly recognized that, even though the AMI was not a covenant that ran with the leases, an assignee of those leases could agree to assume the obligations, although the court found that such an assumption had not occurred in the case before it.¹¹⁶

It should be noted that a dispute can also arise when an original party to an AMI asserts that its rights were *not* conveyed when it conveyed its interest in the leases within the area covered by the AMI. This occurred in *Crowder v. Tri-C Resources, Incorporated*.¹¹⁷ In that case Crowder, one of the parties to an AMI that had conveyed its interest in all of the leases that the parties had originally acquired within the AMI, asserted that it was entitled to share in leases that were later acquired by the other party. Apparently, the parties did not even raise the issue of whether the AMI was a covenant running with the land, and the court found that it was clear under the language of Crowder’s assignment that he had conveyed all of his rights and interests under the AMI.¹¹⁸

As these cases demonstrate, even if the rights and obligations of an AMI are held not to run with oil and gas leases that were within the AMI, an assignment of those leases may convey those rights and obligations if that is shown to be the intent of the parties to the assignment. This point was illustrated with regard to North Dakota law by the recent North Dakota Supreme Court case of *Golden v. SM Energy Company*, a case that involved

113. 861 F. Supp. 2d at 780.

114. *Id.*

115. *Id.* at 785.

116. In a subsequent opinion, the court addressed Wuellner’s contention that even if it was not entitled to its override on all leases taken by EnCana in the AMI, it was entitled to its overriding royalty on replacements of leases that were originally covered by the assignment. Acknowledging that its earlier opinion had not been clear as to whether EnCana did not intend to assume any personal obligations or only that EnCana did not intend to assume any obligations that were unrelated to the assigned leases, the court held that Wuellner had a “colorable claim” to the overriding royalty on replacement leases. *EnCana*, 2013 WL 1289047 at *3. The court went on to reject this claim, however, finding that the assignment did not evidence an intent by EnCana to assume the assignor’s obligation to assign an overriding royalty on replacement leases. *Id.* at *7.

117. 821 S.W.2d 393 (Tex. App. 1991).

118. *Id.* at 398.

an Override AMI.¹¹⁹ A simplified description of the facts in that case is as follows: A.G. Golden (“Golden”) entered into a letter agreement under which it conveyed certain oil and gas leases in McKenzie County, North Dakota to Universal Resources Corporation (“Universal”), reserving a four percent overriding royalty interest. The letter agreement contained a designation of a joint area of interest and provided, among other things, that if Universal acquired any oil and gas leases in the designated area, it would assign Golden a four percent override therein.¹²⁰ The court acknowledged that this type of clause was commonly referred to in the oil and gas industry as an AMI.¹²¹

Subsequently, Universal sold its interest in the oil and gas leases to Tipperary Petroleum Company (“Tipperary”) by an assignment and bill of sale that “included a provision that Universal was assigning ‘all right, title and interest of Assignor in and to. . . all operating agreements, joint venture agreements, partnership agreements, and other contracts, to the extent that they relate to any of the [interests conveyed].’”¹²² Tipperary subsequently acquired an interest in a lease within the AMI that the parties referred to as the “Federal Lease.” Thereafter, Tipperary assigned its interest in the lands and agreements in question to Nance Petroleum Corporation, under an assignment and bill of sale that “provided that Nance ‘assumes all of Assignor’s duties, liabilities and obligations relating to the Assets to which Assignor was a party or by which it was bound on and after the date hereof.’”¹²³ Nance subsequently merged with SM Energy Company (“SM”). At issue was whether SM was obligated to pay Golden the four percent overriding royalty on the Federal Lease.

The trial court found that, as a matter of law, SM was obligated to pay a four percent overriding royalty on the Federal Lease to Golden and the other plaintiffs in the case.¹²⁴ Interestingly, the parties agreed “that the AMI clause is not a covenant that runs with the land, but is a personal covenant that is enforceable only between the original parties to the agreement.”¹²⁵ Therefore, they, and the North Dakota Supreme Court, agreed that the question was whether SM had “agreed to be bound by the

119. 2013 ND 17, 826 N.W.2d 610.

120. *Id.* ¶ 2, 826 N.W.2d at 613.

121. *Id.* ¶ 9, 826 N.W.2d at 615.

122. *Id.* ¶ 3, 826 N.W.2d at 614.

123. *Id.*

124. *Id.* ¶ 5. Although the opinion does not expressly say so, presumably the other plaintiffs were parties to which Golden had assigned portions of the overriding royalty interest. Herein, they will collectively be referred to as “Golden.”

125. *Id.* at 615. It is likely that Golden elected to forego the argument that the covenant ran with the land, based on the holding in the *Beeter* case, discussed *supra* note 82.

AMI clause under the law of assignments.”¹²⁶ The court recognized that the question of whether the AMI was a covenant running with the land was not dispositive of the question of whether it was binding on successors and assigns.

In addressing the question of whether the AMI was binding under the law of assignments, the parties focused on the language in assignment to SM’s predecessor in interest which provided “Assignor . . . does hereby grant, sell, assign, convey, and deliver unto Assignee, all right, title and interest of Assignor in and to . . . all operating agreements, joint venture agreements, partnership agreements, and other contracts, to the extent that they relate to any of the Assets.”¹²⁷ Golden argued, and the trial court agreed, that the reference to other contracts that relate to the conveyed leases included the letter agreement, which provide for the overriding royalty. SM argued that the provision unambiguously established that its predecessor did not assume the obligations of the AMI because the language reflected the parties’ intent to limit the assignment of any agreement to the extent that it related to one of the leases previously assigned. Therefore, the AMI clause only related to properties that might subsequently be acquired by SM’s predecessor and not to property acquired by SM. The North Dakota Supreme Court rejected both the position of Golden and the trial court and the position of SM, concluding instead that the provisions of the relevant documents were ambiguous.¹²⁸

The trial court also concluded that summary judgment in Golden’s favor was appropriate because the SM’s predecessor had constructive knowledge of the letter agreement that provided for the AMI, due to the fact it was recorded. The court acknowledged that SM had constructive notice of the provisions of the agreement since it was duly recorded; however, the court concluded that such constructive notice did not constitute an agreement to be bound by the terms of the AMI.¹²⁹

Finally, the trial court ruled that SM was bound by the terms of the letter agreement under North Dakota statute, which provided that the “voluntary acceptance of the benefit of a transaction is equivalent to a consent to all the obligations arising from it so far as the facts are known or ought to be known to the person accepting.”¹³⁰ In response to this argument, the Supreme Court held:

126. *Id.*

127. *Id.* ¶ 12, 826 N.W.2d at 616-17.

128. *Id.* ¶ 13, 826 N.W.2d at 617.

129. *Id.* ¶ 14, 826 N.W.2d at 617.

130. N.D. CENT. CODE § 9-03-25 (2013).

The court's conclusion that the mere act of entering into a transaction itself is the voluntary acceptance of the benefit of the transaction turns the law of assignment on its head. This construction of the statute turns the AMI clause, as well as any other personal covenant, into a covenant that runs with the land and obliterates the requirement that an assignee consent to be responsible for the obligations of the assignor.¹³¹

The court stated that the statute in question "obviously contemplates extrinsic evidence of conduct after completion of the transaction that suggests a voluntary acceptance of the benefit of the transaction," and that neither the district court, nor *Golden* had put forth evidence of conduct on the part of SM that was inconsistent with its interpretation of the agreement.¹³² Further the court noted that the question of whether a party had voluntarily accepted the benefits of a transaction is better suited for a trier of fact than for summary judgment.

Following the discussion of the issues described above, the Supreme Court noted, "[s]ummary judgment should not be used to conduct mini-trials of factual issues."¹³³ Based on its conclusions discussed above, the Supreme Court concluded that because the provision of the agreement that was in dispute "permits reasonable differing interpretations" summary judgment was inappropriate. Thus, the Court remanded the case to the trial court for a determination of the parties' intentions.¹³⁴

3. *The Current State of the Law*

It is safe to say that *Golden* confirms that in North Dakota an AMI will generally not be deemed a covenant running with the land, and that this result will be obtained regardless of the parties' intent. Thus, a party to an AMI cannot argue that the assignee of an oil and gas interest owned by another party to the AMI is bound by the terms of the AMI because it is a covenant running with the land. *Golden* also makes it clear, however, that this does not mean that an AMI will never be binding on the assignee in that situation; the question is whether the assignee contractually agreed to be bound by the terms of the AMI. Thus, if Company A and Company B are parties to an AMI, Company A conveys to Company C its interest in some oil and gas interests which were subject to the AMI and the conveyance expressly provides that Company C agrees to be bound by the terms of the

131. 2013 ND 17, ¶ 16, 826 N.W.2d at 618.

132. *Id.*

133. *Id.* ¶ 18, 826 N.W.2d at 618.

134. *Id.*

AMI, that agreement will be binding. In addition, Company C may agree by implication to be bound, but as the *Golden* case makes clear, the question of whether this is the case will generally be an issue of fact to be determined by the trial court, based on the relevant evidence.

It is also safe to say that not all jurisdictions treat this issue the way it is treated in North Dakota. As discussed above, the Texas Supreme Court held in *Westland Oil* that an AMI was a covenant running with the land, but this result was criticized and distinguished in the *Walsh* and *Watts* cases. It seems that the law in Texas regarding this area may be subject to further development.

VI. CONCLUSION

Given what may fairly be described as the recent explosion of the oil and gas industry in North Dakota, it is safe to say that AMIs will continue to be used extensively in the state. Along with the many benefits of this increased activity, however, is the unfortunate side effect of a substantially increased pressure to “get the deal done,” which can result in pressure on attorneys to move quickly, cut corners, and be less careful about drafting documents, including AMIs. This pressure is a fact of life and is not easily ignored. That said, attorneys, and all of the parties involved in a deal, should be mindful of the price that may be paid for careless drafting and for otherwise not devoting the time to insure that a deal is properly papered. The expenses and other burdens resulting from litigation over these issues are clearly enough of an incentive for parties to exercise care in this area, but an even greater incentive may be the avoidance of the uncertainty that can result from such disputes. When parties are preparing to spend millions, or even tens of millions of dollars on a drilling program, not knowing who is entitled to what interest can be a crippling burden.

As discussed in this Article, careful drafting by attorneys can generally avoid issues that arise concerning the application of the statute of frauds and the rule against perpetuities to an AMI. Careful drafting by attorneys can also ensure that their documentation reflects the intent of their clients with regard to the question of whether the AMI is binding on successors and assigns, and avoid the type of prolonged litigation that occurred in *Golden*. I would encourage oil and gas attorneys to do their best to explain to clients that a little effort spent now can avoid considerable heartache down the road.

APPENDIX: SAMPLE AMI PROVISION

SECTION ___ AREA OF MUTUAL INTEREST: An Area of Mutual Interest, hereinafter referred to as “AMI” is hereby created by and between the parties hereto, and shall be comprised of all lands described and outlined on Exhibit “___” attached to this Agreement. This AMI shall be subject to the following terms and conditions.

A. Definitions. For the purpose of this Section, the following terms shall have the meanings hereinafter set forth:

1. “Mineral Interest or Interests” shall include any oil and gas leases of any nonproductive horizons contained therein, any unleased mineral interest or any farmouts or options or contractual rights to acquire the same, provided that it is expressly understood and agreed that Mineral Interest shall not include any “producing interest” which is understood to be the productive horizon in any lands that are included in any spacing unit or proration unit or any pooled or unitized area upon which is located one or more wells capable of producing oil and/or gas in paying quantities. It is agreed that if any party shall acquire an interest which includes a Mineral Interest and Productive Interest, the consideration for such acquisition shall be apportioned between the two types of interests, based on a fair market value, and the terms hereof shall apply to the acquired nonproductive Mineral Interest.

2. “Acquisition Cost or Costs” shall include bonuses and all other expenditures related to the acquisition of a Mineral Interest or Interests, including without limitation expenditures for contract brokers, abstracts, and outside attorneys and, in the case of options and contractual rights, shall include an assumption by the Non-Acquiring Party of its proportionate part of all burdens imposed on the Acquiring Party by the related contract, but shall not include any charges for Acquiring Party’s its own personnel.

B. Any-Party May Acquire. Any party may proceed to lease or otherwise acquire Mineral Interests within the AMI.

C. Notification Upon Acquiring Oil and Gas Rights. In the event one of the parties hereto (the “Acquiring Party”) acquires any Mineral Interest lying within the Area of Mutual Interest, it shall promptly notify the other parties hereto (the “Non-Acquiring Party” whether one or more) in writing of such acquisition. Such notice shall include a full description of the Mineral Interest so acquired. A copy of the instrument by which such rights were acquired by the Acquiring Party together with, by way of example but not of limitation, copies of the leases, abstracts, title memos, assignments, subleases, farmouts or other contracts affecting the Mineral Interest; and the Acquisition Cost, including an itemized statement thereof.

D.Option to Participate. Within thirty (30) days after receipt of the notice referred to in Paragraph C, the Non-Acquiring Party may elect to acquire its proportionate interest in the Mineral Interest so acquired by notifying the Acquiring Party in writing of such election. The proportionate interest of each party is as follows:

_____ : ____ %
 _____ : ____ %
 _____ : ____ %

Promptly after the acceptance of the offered Mineral Interest by the Acquiring Party, the Acquiring Party shall invoice the Non-Acquiring Party for its proportionate share of the Acquisition Costs. The Non-Acquiring Party shall immediately reimburse the Acquiring Party for its share of the Acquisition Costs, as reflected by the invoice. Upon receipt of such reimbursement, the Acquiring Party shall execute and deliver an appropriate assignment to the Non-Acquiring Party. Such assignment shall be on a form mutually acceptable to the parties, shall be made without warranty of title, and shall contain no special provisions. If the Acquiring Party does not receive the amount due from the Non-Acquiring Party within thirty (30) days after the receipt by the Non-Acquiring Party of the invoice for its costs, the Acquiring Party may, at its election, give written notice to such delinquent Party that the failure of the Acquiring Party to receive the amount due within forty-eight (48) hours after receipt of such notice by the delinquent Non-Acquiring Party shall constitute a withdrawal by the delinquent Non-Acquiring Party shall no longer have the right to acquire an interest in the offered Mineral Interest. Unless the delinquent Party pays the amount due within said forty-eight (48) hours period, the delinquent Party shall have no right to acquire an interest in the offered Mineral Interest.

E.Election not to Participate. If a Non-Acquiring Party elects not to acquire its interest in an offered Mineral Interest, said Mineral Interest (the "Excluded Mineral Interest"), shall be excluded from the AMI. If the Acquiring Party shall not have received actual written notice of the election of the Non-Acquiring Party to acquire its proportionate interest within the thirty (30) day period pursuant to Paragraph D, such failure shall constitute an election by such Non-Acquiring Party to not acquire its proportionate part of the Mineral Interest.

F.Lands Partially Outside AMI. If the Mineral Interest covers lands both within and out of the AMI, the Acquiring Party shall offer the entire Mineral Interest to the Non-Acquiring Party. If the Non-Acquiring Party acquires its proportionate interest in the lands lying outside of the AMI such lands shall become subject to the terms of this Agreement.

G.No Warranty. Any assignment made by the Acquiring Party shall be made free and clear of any burdens placed thereon by the Acquiring Party but otherwise shall be made without warranty of title, either express or implied, even to the return of the purchase price. The assignment shall be made and accepted subject to, and the Non-Acquiring Party shall expressly assume its portion of, all of the obligations of the Acquiring Party.

H.Term. This Area of Mutual Interest shall remain in force and effect during the period that this Agreement is in effect, and for a period of _____ () years thereafter.