



## Eighth Circuit Weighs in on North Dakota Law in O&G Case

### EIGHTH CIRCUIT BANKRUPTCY MONITOR

In [\*Slawson Exploration Co., Inc. v. Nine Point Energy, LLC \(In re Triangle USA Petroleum Corp.\)\*](#), the Eighth Circuit (Judges Shepherd, Smith, Melloy) held that under North Dakota law, an O&G promote obligation does not run with the land, was not an equitable servitude, and was not a real property interest akin to an overriding royalty. Slawson and the Debtor's predecessor, TPC, were O&G production companies who teamed up to lease, develop and drill land in North Dakota. Under the terms of their agreement (the "EDA"), either party that acquired an O&G leasehold in a specified area of North Dakota was required to offer the other an undivided interest at cost in the proportion specified in the EDA: 70% for Slawson and 30% for TPC. TPC also agreed to pay "an additional 10% of its share of the drilling, completing, and equipping costs for each well in which TPC elect[ed] to participate" – the "Promote Obligation."

TPC's successor filed a voluntary petition for relief under chapter 11. The bankruptcy court confirmed the successor's plan, but reserved Slawson's right to litigate whether the Promote Obligation ran with the land such that it was a real estate interest rather than a contract interest. Slawson filed a declaratory judgment action and the district court found that the Promote Obligation did not run with the land. Slawson appealed and the Eighth Circuit affirmed.

The Eighth Circuit acknowledged that the North Dakota Supreme Court has not adopted a *per se* rule as to whether obligations like the Promote Obligation run with the land. While the Tenth Circuit had so interpreted North Dakota law, the Eighth Circuit found the Promote Obligation here distinguishable in part because it

extended beyond the two-year term of the EDA.

Slawson argued that the Promote Obligation necessarily benefitted the land by encouraging its development – one of the statutory requirements for a covenant to run with the land. The Eighth Circuit focused on that issue, assuming without deciding that the other statutory requirements were satisfied. The Court held that the Promote Obligation – which incentivized development by defraying the risk of drilling – was, “at best, an indirect benefit to the land.”

In reaching that determination, the Court found two points particularly salient. *First*, the Court found that the obligation to pay the additional 10% of costs would apply even if Slawson elected not to participate in a project. This indicated to the Court that Slawson’s receipt of the Promote Obligation payment was a “purely personal benefit” rather than a benefit to the land. *Second*, there was no requirement that Slawson use the Promote Obligation payment to further development of the land; rather, it could be used by Slawson for any purpose. Thus, the Court found there was “no direct relationship under the EDA between the Promote Obligation and Slawson’s participation in drilling projects.”

The Court then, in rather summary form, rejected Slawson’s argument that the Promote Obligation was an equitable servitude. The Court found that Slawson omitted to identify any North Dakota case authority on point, and therefore declined to find that the district court erred in finding that the Promote Obligation was not an equitable servitude.

Finally, the Court rejected Slawson’s argument that the Promote Obligation was a real property interest similar to an overriding royalty. While a royalty entitles the owner to a share of profits issuing out of the land, the Promote Obligation was a mere cost-sharing arrangement.

As we continue to see more distress in the O&G space, particularly in the upper mountain states, we can expect the Eighth Circuit’s holding here to carry important weight.

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