CONSENT TO ASSIGNMENT PROVISIONS IN TEXAS OIL AND GAS LEASES: DRAFTING SOLUTIONS TO NEGOTIATION IMPASSE

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I. THE BASICS OF OIL AND GAS LEASE CONSENT TO ASSIGNMENT PROVISIONS

Standard form oil, gas, and mineral leases typically provide that both the lessor and lessee may assign their interests and bind a party's successors to the lease.[1] A lessor's and lessee's interests naturally diverge in the oil and gas lease assignment provisions: transfer of lease ownership by lessees is extremely common but often undesirable to the lessor.[2] Therefore, lessors are more likely to stipulate that a lessee cannot assign its interest in whole or in part without the lessor's prior consent.[3] Lessors are also more likely to draft additional provisions to protect themselves from what lessors see as inequitable or otherwise detrimental assignments.[4]

In contemporary oil and gas leases, the lessor may insist on the inclusion of "consent to assignment" provisions to protect itself from an assignment that does not meet the lessor's expectations when executing the lease with the original lessee.[5] Under Texas law, an oil and gas lease is a conveyance by the mineral lessor of a fee simple determinable interest, and the lessor may have to live with a lessee or its successors for decades to come.[6] An assignment to an insolvent or undercapitalized company or an operationally inexperienced operator could result in diminished royalties to the lessor, the inability to recover damages in the event of a breach of the lease, environmental harm, or another actionable offense by the assignee–lessee.[7] Other potential concerns for a lessor include assignment to an operator who has a history of production problems, a reputation for

1. 1 ERNEST E. SMITH & JACQUELINE LANG WEAVER, TEXAS LAW OF OIL AND GAS § 4.9[B] (LexisNexis Matthew Bender 2015).
2. *See, e.g.*, *id.*
3. *See id.*
4. *Id.*
5. *See id.*
6. *See, e.g.*, Sheffield v. Hogg, 77 S.W.2d 1021, 1028 (Tex. 1934).
7. *See generally* Thomas E. Meng, *Limitations on the Right to Transfer Mineral Leases*, 9 E. MIN. L. INST. 12 (1988) (discussing in full the lessor and lessee considerations influencing lease assignments).

underpaying lessor royalties, trouble securing necessary permits, or insufficient financial resources to aggressively exploit the minerals.[8]

Lessees are appropriately wary of onerous consent to assignment provisions; the consent requirement can reduce the value of the lessee's interest by impeding the free transferability of the lease.[9] This is particularly the case when the lessor has a history of being particularly difficult or unreasonable to deal with.[10] Onerous consent requirements on a lessee could hamper or prevent the monetization of a lease by assignment.[11] Release of an unexpired lease results in a sunk acquisition cost to the lessee, while an unexpired lease remains valuable to the lessee by assignment through farmouts and exchanges, which can result in the lessee's recovery of partial or full acquisition costs, or even a profitable return on its investment.[12] Freely assignable leases can also be sold to avoid contractual obligations when unforeseen events, such as declines in commodity price, make production on the property unprofitable for a lessee.[13] Further, a lessee's focus on which prospects to pursue changes over time, leaving flexibility and opportunity for both a lessee, whose operational focus is better spent on a different prospect, and an assignee, whose focus and interest is in the prospect being exited by the lessee.[14]

A basic consent to assignment provision in an oil and gas lease provides:

> "This lease may be assigned only with the written consent of the lessors."[15]

Contemporary lessees find such an unrestrained consent provision untenable because a lessor may arbitrarily withhold or condition consent on additional, unwarranted consideration.[16] Lessees accordingly insist on a basic reasonableness requirement to avoid the arbitrary withholding of consent or a lessor's demand for additional consideration (or even renegotiation of other lease provisions):

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8. *See id.*

9. *See* Bruce E. Cryder & R. Clay Larkin, *Consent Provisions in Natural Resource Agreements*, *in* 30 ENERGY & MIN. L. INST. 57, 57–61 (2009).

10. *Id.*

11. *Id.*

12. *Id.*

13. *Id.*

14. *Id.*

15. Shields v. Moffitt, 683 P.2d 530, 531 (Okla. 1984). One issue raised in *Moffitt* is whether a consent to assignment clause is an invalid restraint on alienation. *Id.* To avoid such a determination, Professors Smith and Weaver suggest either (1) phrasing provisions as covenants running with the land so that the right to exercise the consent provision is held by the interest owner or (2) phrasing the lessor consent requirement as a condition subsequent—terminating the lease on assignment without consent. SMITH & WEAVER, *supra* note 1, at § 4.9[C][2].

16. *See* Mitchell's, Inc. v. Nelms, 454 S.W.2d 809, 813–14 (Tex. Civ. App.—Dallas 1970, writ ref'd n.r.e.).

> "That the rights of the parties hereto shall not be assigned without the written consent of the other parties, *which consent shall not be unreasonably withheld*."[17]

As a practical matter, however, this very common and simple clause offers lessors little protection from unpalatable assignments or assignees because, to prevail, a lessor must show damages arising out of the breach of the assignment restriction.[18] Additionally, the due diligence of a potential assignee would reveal a lessee's failure to secure consent, potentially resulting in a lost sale.[19] If it is later determined that the lessor's consent was unreasonably withheld, the lessor may be liable to the lessee for a lost sale of the assigned interest.[20]

Given the potentially significant impact of consent to assignment provisions and their associated risk shifting, both lessors and lessees should insist on clear and concise provisions that satisfy each party's needs according to each party's leverage.[21] In Part II, this Article discusses guidance provided by legal authorities, helpful to both litigators and draftsmen, including examples of clauses that have been subject to and tested in litigation. In Part III, this Article discusses remedies for noncompliance (whether by lessors or lessees). Each of these Parts contributes to the drafting recommendations and considerations discussed in Parts IV and V.

II. LEGAL GUIDANCE ON CONSENT TO ASSIGNMENT PROVISIONS

Because standard oil and gas lease consent to assignment provisions prohibit a lessor from *unreasonably* withholding consent, the facts and circumstances surrounding a lessor's non-consent dictate the result of any particular case.[22] The reasonableness of withheld consent is a question of fact.[23] At the time this Article was drafted, there is no single published Texas case discussing factors for reasonability considerations in oil and gas consent to assignment provisions. Noting that Texas courts have not settled on a legal definition of *unreasonable*, one court observed that "[w]hat constitutes the

17. *See* Palmer v. Liles, 677 S.W.2d 661, 663 (Tex. App.—Houston [1st Dist.] 1984, writ ref'd n.r.e.) (emphasis added).

18. *Id.*

19. *See id.*

20. Oliver Res. PLC v. Int'l Fin. Corp., 62 F.3d 128, 130–31 (5th Cir. 1995) (applying Texas law).

21. *See infra* Parts II–IV.

22. *See* Ridgeline, Inc. v. Crow-Gottesman-Shafer #1, 734 S.W.2d 114, 116 (Tex. App.—Austin 1987, no writ).

23. *See, e.g.*, *id.*

elements of unreasonableness in the act of withholding consent presents a question not simple in resolution."[24]

Outside of the oil and gas lease context, reasonability factors to consider include the intended use of the property, the financial status of an assignee, and evidence supporting the commercial reasonableness of the denial.[25] It is appropriate, if not necessary, to draw lessons from consent to assignment provisions in landlord–tenant relations and general corporate transactions, as well as to view the treatment of consent to assignment provisions by other jurisdictions.

A. Lessons from Texas Authorities

1. Drafters Must Include a Standard in a Non-consent Provision

A consent to assignment provision that fails to set a standard by which to measure consent (such as reasonableness or good cause) allows a lessor to withhold consent arbitrarily.[26] The Eastland Court of Appeals considered a commercial tenancy in which the lessee sought to transfer its interests when the lease provided:

> 13.4. *ASSIGNEE, TRANSFEREE OR RECONSTITUTED LESSEE*. Anything herein contained to the contrary notwithstanding, any permitted assignee, permitted transferee or reconstituted LESSEE must be comprised solely of QUALIFIED PERSONS. Moreover, any such assignment, transfer or reconstitution shall be null and void and of no force or effect unless LESSOR shall first have given its written consent to any such assignment, transfer or reconstitution. The withholding or granting of such consent shall be predicated upon LESSOR's right to review and approve the Partnership Agreement (or Articles of Incorporation, Bylaws and Stock Agreements in the case of a corporation) of any such entity; upon any such entity being comprised solely of QUALIFIED PERSONS; and upon the

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24. Burlington N. & Santa Fe Ry. Co. v. S. Plains Switching, Co., 174 S.W.3d 348, 352 (Tex. App.—Fort Worth 2005, no pet.) (quoting Mitchell's Inc. v. Nelms, 454 S.W.2d 809, 813 (Tex. Civ. App.—Dallas 1970, writ ref'd n.r.e.)).

25. *See* Johnson v. Jaquith, 189 So. 2d 827, 829–30 (Fla. Dist. Ct. App. 1966) (describing how refusal to consent to an assignment is not unreasonable without proof of the prospective assignee's financial status); Bismarck Hotel Co. v. Sutherland, 529 N.E.2d 1091, 1097 (Ill. App. Ct. 1988) (holding that a suitable sublessee is "one who is ready, willing and able to sublease the premises and who, at least, meets reasonable commercial standards"); Pletz v. Standard Homes Co., 342 S.W.2d 621, 621 (Tex. Civ. App.—San Antonio 1961, no writ) (discussing how a landlord's desire to prevent business competition between tenants justified his refusal to consent to a sublease without first obtaining knowledge of intended use of property).

26. Trinity Prof'l Plaza Assocs. v. Metrocrest Hosp. Auth., 987 S.W.2d 621, 625 (Tex. App.—Eastland 1999, pet. denied) (citing Reynolds v. McCullough, 739 S.W.2d 424, 429 (Tex. App.—San Antonio 1987, writ denied)).

> compliance or non-compliance with the governing documents of such entity with the terms of this GROUND LEASE.[27]

Among other arguments, the lessee proposed that the lessor acted unreasonably in refusing to consent to the proposed assignment, but the court determined that the "[l]essee did not contract for a reasonableness provision in the ground lease. Section 13.4 of the lease [gave the] lessor the absolute right to withhold consent."[28] In this situation, Texas departs from the Restatement of Property and the general trend towards reading a reasonableness requirement into a consent provision that does not articulate a standard.[29]

It is, therefore, extremely important for a lessee that *some* standard be articulated, whether it is a reasonableness standard (offering lessors the greatest leeway and lessees the least predictability) or a specifically enumerated objective standard (offering lessees the greatest predictability and lessors the least leeway). Proposed options for standards by which consent may be governed are identified in Part IV.

2. A Material Change in Lessee's Operations May Constitute Good Cause for Withheld Consent

Texas courts have determined that withholding consent due to immediate economic concerns is not unreasonable.[30] In *Pletz v. Standard Homes Co.*, a landlord–tenant case, the San Antonio Court of Appeals upheld a lessor's refusal to consent to an assignment under a "good cause" consent standard.[31] The lessors in the *Pletz* case proved at trial "that they refused to deal with anyone unless they knew" the assignee's intent with respect to the property.[32] The lessors were not informed of the assignee's intent after repeated inquiry, and established that they sought to avoid duplications of businesses so that tenants would not be forced to compete with each other.[33] At trial, the assignee testified that he intended to destroy the leased premises.[34]

Pletz is not directly applicable to oil and gas lease consent provisions because the development of a mineral estate is not comparable to the use of

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27. *Id.* at 623.

28. *Id.* at 625.

29. Cryder & Larkin, *supra* note 9, at 115; *see* RESTATEMENT (SECOND) OF PROP.: LANDLORD AND TENANT § 15.2(2), Westlaw (database updated Oct. 2015).

30. *E.g.*, Mitchell's, Inc. v. Nelms, 454 S.W.2d 809, 814 (Tex. Civ. App.—Dallas 1970, writ ref'd n.r.e.).

31. Pletz v. Standard Homes Co., 342 S.W.2d 621, 621 (Tex. Civ. App.—San Antonio 1961, no writ).

32. *Id.*

33. *Id.*

34. *Id.*

surface premises: assignees of the surface may have *very* different ideas for development and improvements, while both an oil and gas lessee and its assignee ultimately seek economic exploitation of the mineral estate; however, the case provides some useful guidance. [35]

First, a "material change" in use almost certainly satisfies the good cause standard.[36] The way an assignee plans to develop the mineral estate may be such a material change from prior development that a lessor's objection satisfies the good cause standard.[37] But a lessor is usually unaware of a lessee's development plans, much less an assignee's development plans, to make a basis for comparison at the time good cause must be shown, and operators are typically hesitant to disclose much of their planning due to the likelihood of schedule changes and concerns about competition. Much more common would be a difference in royalty payment administration, because operators sometimes account for royalties differently under the same operative lease royalty provisions.[38] A lessor may already have another property operated by the assignee and be able to make a comparison between royalty payment methods to establish good cause.

Second, the case warns lessees of the risk of not communicating with a lessor.[39] The tenant's obstruction was used by the lessors as evidence against the tenant.[40] Oil and gas lessees should consider whether, under the circumstances, clear communication with a lessor about the lessee–assignee is required to avoid an adverse implication, even absent a contractual requirement.

3. Trial Counsel Should Carefully Consider How Unreasonable Consent Is Charged to the Jury

A lessee facing a lawsuit by a lessor for breach of the consent to assignment provision may also utilize the provision defensively, arguing that by unreasonably withholding consent, the lessor breached the lease prior to the lessee's breach.[41] *Trinity Materials, Inc. v. Sansom*, a sand and gravel mining case, cautions litigators on the importance of a clear jury charge in consent to assignment cases.[42] A few years after the parties entered into the

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35. *See id.* (suggesting that the lessee was a typical commercial tenant, but that the proposed assignee intended to bulldoze the assigned premises).

36. *See id.*; *see also* Grossmann v. Barney, 359 S.W.2d 475, 477 (Tex. Civ. App.—San Antonio 1962, writ ref'd n.r.e.) ("The use and reputation of [a] location for a short period of time can affect the future value of the property.").

37. *See Pletz*, 342 S.W.2d at 621.

38. *See* Chesapeake Expl., L.L.C. v. Hyder, No. 14-0302, 2015 WL 3653446, at *2–3 (Tex. June 12, 2015).

39. *See Pletz*, 342 S.W.2d at 621.

40. *See id.*

41. *See, e.g.*, Trinity Materials, Inc. v. Sansom, No. 03-11-00483-CV, 2014 WL 7464023, at *5–7 (Tex. App.—Austin Dec. 31, 2014, pet. filed).

42. *Id.* at *1–7.

lease, the governing body for the town in which the lease was located passed ordinances requiring mining permits and creating zoning regulations.[43] In response, the lessee proposed options to the lessors to try to satisfy the new ordinances.[44] One solution was to re-zone the property, but the lessor refused; the lessee filed suit against the lessor, claiming the lessor breached its obligation under the lease to assist the lessee in re-zoning efforts by agreeing to re-zone.[45] The lessee submitted three plans to the lessor, all of which were rejected.[46] One of the lessee's theories was that the lessor breached the lease by unreasonably withholding consent.[47] After trial, the jury answered "Yes" to the charge question of whether the lessor "unreasonably with[eld] consent to a mining plan and/or construction plan."[48] The full charge to the jury read:

> **QUESTION 1** Did the Landowners fail to comply with the Sand and Gravel Lease by unreasonably withholding consent to a mining plan and/or a construction plan? You are instructed that "unreasonably withholding consent" should be determined by reference to the terms and conditions of the Sand and Gravel Lease. You are instructed that, in addition to express promises, every contract contains an implied promise that a party will not do anything to delay or prevent the other party from performing his part of the contract. You are instructed that the Landowners made no express promise to apply for rezoning of their property and there is no implied promise to apply for rezoning.[49]

The jury was also charged with a question as to whether the lessee breached the lease (answered affirmatively), and who breached the lease first (answered as the lessee).[50] The lessee essentially argued that the lessor's breach occurred first because, by unreasonably withholding consent on the plans, the lessor must have breached first.[51]

The Austin Court of Appeals rejected the lessee's argument based on the language of the charge; question one asked whether the lessor breached "by unreasonably withholding consent to a mining plan and/or a construction plan."[52] The court noted that the question did not ask about a specific mining

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43. *Id.* at *1.
44. *Id.* at *1–2.
45. *Id.*
46. *Id.* at *4–5.
47. *Id.* at *5–6.
48. *Id.* at *5–7.
49. *Id.* at *9 n.7; *see also* Court's Charge at 3, Trinity Materials, Inc. v. Sansom, No. D-1-GN-09-004105 (201st Dist. Ct., Travis County, Tex. Feb. 14, 2011), 2011 WL 2325375.
50. *Sansom*, 2014 WL 7464023, at *9 n.7.
51. *Id.* at *6.
52. *Id.* at *2.

plan, and "[a]s such, the jury's answer to Question 1 indicate[d] only that it found that the [lessor] had unreasonably rejected at least one of the three mining plans."[53] Because the lessee could have breached prior to the final plan, and because of the wording of the charge, the jury found that the lessee could have been the first party to breach.[54]

Where a lessee has proposed multiple alternatives—or even where a lessee has made the same offer multiple times—trial counsel should be particularly careful to charge exactly what proposal was rejected; otherwise, if a lessee acts without consent, a lessor may argue that the lessee's acts constituted a breach prior to the unreasonably withheld consent.[55] Trial counsel should also be aware that, because Texas does not recognize a legal definition of *unreasonable* in this context, no definition should be charged to the jury.[56]

4. Drafters Should Carefully Consider the Consequences of Circumvention Language

In a recent case, the El Paso Court of Appeals discussed the effect of an assignment provision that stated:

> Any assignment, sale or transfer of, or agreement to sell, assign or transfer any interest or interests of Lessee in or under this Lease may not be made by Lessee, other than to Assignee's [sic] subsidiaries, affiliates, internal partners, AMI partners and Petro-Hunt L.L.C., without the prior written consent of Lessor, which consent shall not be unreasonably withheld and any assignment, sale or transfer so made shall expressly be subject to all the terms and provisions of this Lease, and the assignee expressly agrees to be bound by the terms hereof in writing. Lessee shall furnish Assignor [sic] a fully-executed copy of any such sale, assignment or transfer.[57]

The court noted that the plain language of the lease allowed the lessee to convey whatever rights and obligations it wanted to its area of mutual interest (AMI) partners without notifying the lessors, regardless of whether those AMI partnerships existed at the lease's inception.[58] The lessors argued that by allowing the lessee to create new AMI partners subsequent to the

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53. *Id.* at *6.

54. *Id.*

55. *See id.*

56. Burlington N. & Santa Fe Ry. Co. v. S. Plains Switching, Co., 174 S.W.3d 348, 354 (Tex. App.—Fort Worth 2005, pet. denied) ("Because no legal definition of 'unreasonable' has been adopted or approved by Texas courts, the trial court did not err by refusing to submit a definition of the word 'unreasonable' to the jury. We hold that the jury was free to consider the ordinary meaning of the phrase in light of the evidence presented.").

57. Clayton Williams Energy, Inc. v. BMT O & G TX, L.P., No. 08-14-00133-CV, 2015 WL 4134577, at *1 (Tex. App.—El Paso July 8, 2015, pet. filed).

58. *Id.* at *6.

execution of the lease, the lessee rendered the assignment clause meaningless.[59] The court disagreed; the lessee still had to provide notice if it transferred to "non-trusted third part[ies]," and the lessors "would still have veto power over that transfer if it was unreasonable."[60] Under the language of that lease, the lessee was free to enter AMI agreements designating new AMI partners without notice to the lessor.[61]

The case cautions lessors regarding the importance of memorializing their subjective intent in clear, concise, and unambiguous terms—should the lessors have sought to limit AMI partners to then-existing AMI partners, they could have either so-limited it or actually listed the then-existing AMI partners.[62] When drafting consent to assignment provisions, drafters should carefully consider how alternative business transaction structures could creatively avoid the consent requirement while still remaining within the letter of the contract.[63] Creative structuring can work to a lessor's detriment and to a lessee's advantage. Next, this Article discusses one common method of avoiding a consent to assignment requirement.

5. Drafters Should Consider Creative Solutions to Avoid Consent Requirements—The "Texas Two-step"

One method lessees may use to avoid consent to assignment provisions is to structure the third party's procurement through acquisition, merger, or conversion. By statute, when a merger occurs, interests in real property "owned by each organization that is a party to the merger is allocated to and vested . . . in one or more of the surviving or new organizations . . . without . . . any transfer or assignment having occurred."[64] The same rule applies to organizational conversions.[65] Thus, the consent to assignment provision may not be triggered when a third party procures a lease through a merger.[66]

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59. *Id.*

60. *Id.*

61. *Id.* at *6–7.

62. *Id.*

63. *See, e.g.*, Tenneco Inc. v. Enter. Prods. Co., 925 S.W.2d 640, 642–45 (Tex. 1996).

64. TEX. BUS. ORGS. CODE ANN. § 10.008(a)(2)(c) (West 2012); *see also* TXO Prod. Co. v. M.D. Mark, Inc., 999 S.W.2d 137, 142 (Tex. App.—Houston [14th Dist.] 1999, pet. denied) (discussing the effects of a merger on the property of corporations).

65. TEX. BUS. ORGS. CODE ANN. § 10.106(2)(c).

66. *But see M.D. Mark, Inc.*, 999 S.W.2d at 141 (distinguishing the merger at issue from contrary case authority because, in the contrary authorities, "the corporations merged into unrelated entities" while in *M.D. Mark, Inc.*, "a subsidiary merged into a parent corporation"); PPG Indus., Inc. v. Guardian Indus. Corp., 597 F.2d 1090, 1092–93, 1095 (6th Cir. 1979) (distinguished authority); Nicolas M. Salgo Assocs. v. Cont'l III. Props., 532 F. Supp. 279, 280–81, 283 (D.D.C. 1981) (distinguished authority).

The "Texas two-step" has been successfully used to avoid preferential rights provisions in certain contracts.[67] It is likewise available to lessees when a lease allows for a lessee to assign to affiliates or subsidiaries without lessor's consent.[68] The process is simple. Step One: The lessee assigns its interest to a newly formed subsidiary.[69] Step Two: The newly formed subsidiary sells 100% of its stock to the acquiring third party.[70] Because the stock sale of the affiliated company does not result in an assignment, no "assignment" has occurred to trigger the consent to assignment provision.[71]

Lessees that are large or complex entities will seek to secure the right to assign to subsidiaries and affiliates without the lessor's consent; thus, a lessor who is concerned about this potential workaround should consider additional language limiting this approach.[72] Suggested language is discussed below in Part IV. Lessees who already have access to the Texas two-step should utilize it as appropriate, but the transaction costs associated with structuring these transactions are likely disproportionately high compared to simply requesting a lessor's consent.[73] The costs may, however, be less than litigating against an unreasonable lessor when enough property is at stake.[74] Although the Texas two-step may potentially draw additional complaints or claims by a lessor, it is likely to be subsequently upheld if a lessor pursues recourse against a lessee who utilizes it because the Texas Supreme Court approved this practice in the preferential rights context and the strategy is expressly approved by statute.[75]

B. Reasonableness Factors Identified by Other Jurisdictions

Because Texas has created no legal standard for reasonableness,[76] in a Fifth Circuit commercial tenancy case, the federal jury was unhelpfully

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67. *See Tenneco Inc.*, 925 S.W.2d at 645 (holding that a preferential rights provision was not triggered by a merger); John R. Cooney, Recent Developments Concerning Joint Operating Agreements—Preferential Rights and Exculpatory Clauses § 1.01[4][b] (Apr. 3, 2004), http://www.modrall.com/files/1218_preferential_rights_and_exculpatory_clauses.pdf (presented at the 55th Annual Program on Oil and Gas Law).

68. *See* Clayton Williams Energy, Inc. v. BMT O & G TX, L.P., No. 08-14-00133-CV, 2015 WL 4134577, at *6–7 (Tex. App.—El Paso July 8, 2015, pet. filed) (noting that a lessee "could easily accomplish the [transfer without consent] by forming new subsidiaries or obtaining new affiliates"). For a thorough and thoughtful discussion of utilizing the two-step to avoid anti-assignment and anti-transfer provisions, see Philip M. Haines, Comment, *The Efficient Merger: When and Why Courts Interpret Business Transactions to Trigger Anti-Assignment and Anti-Transfer Provisions*, 61 BAYLOR L. REV. 683 (2009).

69. *See Tenneco Inc.*, 925 S.W.2d at 642, 644–46.

70. *See id.*

71. *See id.*

72. *See id.* at 644–46.

73. *See id.*

74. *See id.*

75. *See id.* at 645–46.

76. Burlington N. & Santa Fe Ry. Co. v. S. Plains Switching, Co., 174 S.W.3d 348, 354 (Tex. App.—Fort Worth 2005, pet. denied).

charged on reasonability: "The term 'unreasonable withholding of consent' means that a decision to withhold consent is made without any reasonable basis. . . . [T]he question is whether there was any reasonable basis under the circumstances for the decision[] . . . to withhold its consent."[77] Without helpful legal guideposts to aid the practitioner, surveying the law of non-Texas jurisdictions proves essential; outside of Texas, courts and commentators have distilled three factors to consider for reasonableness of a lessor's withheld consent specifically in oil and gas leases.[78]

The first factor is the ability of the assignee to perform its obligations under the lease.[79]

> A reasonable lessor . . . would only consent to an assignment to a lessee who has the resources to drill or mine at a reasonable rate, the financial ability to maintain its drilling or mining operation (or pay delay rentals), and who has a history of legal compliance sufficient to allow it to obtain necessary permits.[80]

Relatedly, the second factor is the lessor's right to information about the prospective assignment, including the proposed use of the property and the prospective assignee's financial information, permit compliance history, and major outstanding obligations.[81] Without this kind of information, "due diligence and the exercise of reasonable business judgment are impossible."[82] Much of the information proposed as important in assessing reasonableness is publicly available from the Railroad Commission of Texas.[83] Thus, in the oil and gas leasing context in Texas, a lessor should be able to obtain, from a simple internet query or a call to the Commission, pertinent historical information regarding a prospective assignee to base either the consent to or the reasonable withholding of consent to an assignment.[84] This places the typical oil and gas lessor in a better position than a lessor in a typical commercial transaction, who, without a provision requiring data in a lease, may have no access to pertinent data upon which to make a determination. These factors go to the heart of the lessor's interest in

77. Perez v. Jefferson Standard Life Ins. Co., 781 F.2d 475, 479 (5th Cir. 1986) (applying Texas law).

78. *See* Cryder & Larkin, *supra* note 9, at 95–98.

79. *Id.*

80. *Id.* at 95.

81. *Id.* at 97.

82. *Id.*

83. *See Online Research Queries*, RAILROAD COMMISSION TEX., http://www.rrc.state.tx.us/about-us/resource-center/research/online-research-queries/ (last updated July 31, 2015).

84. *See Oil and Gas Well Records*, RAILROAD COMMISSION TEX., http://www.rrc.state.tx.us/oil-gas/research-and-statistics/obtaining-commission-records/oil-and-gas-well-records/ (last updated July 21, 2015).

the provision—to protect itself from an assignment that would injure the lessor's interest.[85]

The third factor identified by commentators is whether the lessor considers the prospective transferee a competitor of the lessor or the lessor's other leases.[86] While there is a split of authority in jurisdictions as to whether this factor is a reasonable basis to withhold consent, this factor should rarely apply in oil and gas leases because operators typically do not lease interests to competitors—they are more likely to either develop the interest, or simply divest themselves of the interest entirely in a transaction.[87]

III. REMEDIES FOR LESSOR'S OR LESSEE'S NON-COMPLIANCE

An assignment of an oil and gas lease creates a privity of estate between the lessor and the assignee.[88] Thus, lessee–assignees are liable to lessors for lease covenants running with the land; similarly, lessee–assignees may enforce lease covenants running with the land against a lessor.[89] Having contractual privity, it is often forgotten that lessors can also seek redress against the original lessee.[90] But recall that the qualifier of reasonability exists to protect the lessee from the lessor's arbitrary decision to withhold consent; accordingly, the provision in a lease or contract that the lessor will not unreasonably withhold consent is "intended to be a promise or covenant on the part of the lessor."[91] Accordingly, depending on the circumstances, a lessor, lessee, or assignee may have rights to pursue remedies against a breaching party.[92]

A. Damages

Damages are available to a lessor when a lessee wrongfully assigns a lease without obtaining consent and the wrongful assignment results in actual damages.[93] The potential for actual damages for assignment are plentiful in

85. *See* Cryder & Larkin, *supra* note 9, at 59, 95–96.

86. *See id.* at 95–98.

87. *See id.* at 98 n.22.

88. *Id.* at 95–99.

89. *See id. But see* Oliver Res. PLC v. Int'l Fin. Corp., 62 F.3d 128, 132 (5th Cir. 1995) (applying Texas law) (holding that a third party that is not an intended beneficiary of a joint operating agreement has no standing to sue on the contract).

90. *See* Cryder & Larkin, *supra* note 9, at 95–99.

91. Mitchell's, Inc. v. Nelms, 454 S.W.2d 809, 813 (Tex. Civ. App.—Dallas 1970, writ ref'd n.r.e.).

92. *See id.*

93. *See* Palmer v. Liles, 677 S.W.2d 661, 665 (Tex. App.—Houston [1st Dist.] 1984, writ ref'd n.r.e.) ("[T]he breach of a provision preventing assignment without consent of the original party will support an action for damages *when the party has suffered damages as a result of the breach*."). A jury may sympathize with a lessor that withholds consent on the basis that, while the lessor leased in a depressed market for a minimal value (e.g. $500/acre), the lessee takes advantage after a change in market conditions to flip the lease at a premium (e.g. $5,000/acre); nevertheless, a court should hold a lessor to the benefit of the bargain he or she struck.

oil and gas leases. Operators typically bear different costs in both production and post-production, and depending on the wording of a lease royalty provision, different deductions may be available to an assignee (particularly when the assignee is not a subsidiary or affiliate of the original lessee) than are available to the original lessee.[94] Oil and gas leases are sometimes structured to allow greater deductions to non-affiliated third parties than to affiliates.[95] This means that a lessor whose royalty is currently valued and calculated in one manner prior to the assignment might have their royalty calculation and valuation changed due to an assignment of the lease to a party who has a different gas or crude marketing arrangement.[96] In such an instance, a lessor might reasonably withhold consent because of a material change in royalty payments by the new assignee.[97] On the other hand, a lessee may argue that a lessor who has signed a lease form that was negotiated with two different payment standards cannot reasonably withhold consent because the royalty calculation under the negotiated provisions changes.[98]

A lessee can likewise recover from a lessor should a breach of the covenant to not unreasonably withhold consent cause the lessee damages.[99] A common actionable breach that may result in a lessee recovering damages from a lessor occurs when a lessor improperly conditions consent on payment of additional consideration.[100] Should the lessor offer no objectively reasonable basis, such conditioning should be treated as unreasonable.[101] Courts look at the intent of the parties to the original lease; thus, it should be unreasonable to withhold consent based on additional terms not in the original lease (i.e., additional consideration) as long as the assignee can fulfill the same obligations undertaken by the original lessee (e.g., delay rentals and payment of royalties).[102] No Texas authority has yet reached that result, however, and given the legal uncertainty under standard consent to assignment provisions, lessees should include additional language in prospective leases to clarify that unreasonable conditioning is inappropriate.[103]

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94. *See* Chesapeake Expl., L.L.C. v. Hyder, No. 14-0302, 2015 WL 3653446, at *2–3 (Tex. June 1, 2015) (discussing the developing law in royalty deductions and third-party affiliates).

95. *See id.*

96. *See id.*

97. *See id.*

98. *See id.*

99. Mitchell's, Inc. v. Nelms, 454 S.W.2d 809, 813 (Tex. Civ. App.—Dallas 1970, writ ref'd n.r.e.).

100. *See, e.g.*, B.M.B. Corp. v. McMahan's Valley Stores, 869 F.2d 865, 869 (5th Cir. 1989) (applying Texas law).

101. *See id.*

102. *See id.* at 868–69.

103. *See id.* at 868 ("[T]he Supreme Court of Texas . . . has not squarely ruled on what is a reasonable refusal to consent to the assignment of a lease.").

Tort causes of action may also be applicable.[104] Applying Texas law under a consent to assignment provision in a joint operating agreement, the Fifth Circuit impliedly approved tortious interference as a cause of action.[105] The damages available for tortious interference are the same as those available in a breach of contract action—to put the lessee in the same economic position that the lessee would have been in if the contract had been performed.[106] As a practical matter, proceeding on a breach cause of action is preferable to a tortious interference claim because lessees are certainly in contractual privity with a lessor, it may be easier to evidence breach damages than tortious interference damages, and attorney's fees for breach of contract are readily available.[107] Because an assignee that is not an intended third-party beneficiary and therefore does not maintain contractual privity with a lessor on covenants that do not run with the land, an assignee may sue in tort to secure a remedy;[108] however, courts will typically construe a consent to assignment provision as a covenant running with the land, allowing an assignee to sue for damages on the contract.[109]

B. Specific Performance and Declaratory Judgment

When faced with a non-consenting lessor, a lessee may decide to undertake significant risk by transferring title despite the lessor's non-consent.[110] "A court may simply disagree with the lessee/assignor's legal theory and find either that the agreement did require consent, or that consent was not unreasonably withheld."[111] The lessee could thereby be subject to damages, as discussed above.[112] And where a lessee fails to request consent because the lessee *believes* a lessor will withhold consent (regardless of whether the lessor would have withheld consent), a court may find a breach.[113] While risky, such a course offers a lessee the advantage "that a lessor may simply waive the breach of the consent requirement," thereby avoiding litigation.[114] In the Authors' experience, lessee reliance on the

104. *See* Oliver Res. PLC v. Int'l Fin. Corp., 62 F.3d 128, 130–31 (5th Cir. 1995) (applying Texas law).

105. *See id.* (dismissing a tortious interference claim because it accrued outside the limitations period).

106. Am. Nat'l Petroleum Co. v. Transcon. Gas Pipe Line Corp., 798 S.W.2d 274, 278 (Tex. 1990).

107. *See* TEX. CIV. PRAC. & REM. CODE ANN. § 38.001 (West 2015).

108. *See Oliver Res.*, 62 F.3d at 132 (determining that a third party who is not the intended beneficiary "may not sue on the contract" to enforce a consent to assignment provision).

109. *See* Mitchell's, Inc. v. Nelms, 454 S.W.2d 809, 813 (Tex. Civ. App.—Dallas 1970, writ ref'd n.r.e.) (stating that courts will construe a consent to assignment lease provision as a covenant for "which an action for damages may be grounded for breach thereof").

110. *See* Cryder & Larkin, *supra* note 9, at 102.

111. *Id.*

112. *See id.*

113. *See* Tage II Corp. v. Ducas (U.S.) Realty Corp., 461 N.E.2d 1222, 1223–24 (Mass. App. Ct. 1984).

114. *See* Cryder & Larkin, *supra* note 9, at 102.

protection afforded by waiver is not uncommon, especially in cases of leases that are valued with low priority or dollar amounts.

A lessee may not want to risk an action for breach; an assignee may demand certainty before undertaking a transaction in which a failure to obtain consent could result in title failure, or assume risk when the asset in question is significant in value.[115] Lessees in this situation may seek specific performance for wrongfully withheld consent, requiring a lessor to give consent.[116] Such a request may be accompanied by a request of a declaration construing the consent to assignment provision, particularly when the provision is complex.[117]

One benefit to setting forth enumerated, objective factors as to when one may withhold consent is that a lessee may more easily evidence objective factors to obtain a declaration as a matter of law than to obtain a determination of reasonableness—when genuine issues of material fact are almost certain to require a trial.[118] Objective factors may address a lessee's concerns for predictability by allowing a lessee to gather evidence that such objective factors have been met under the lease.[119] The lessee could then file for declaratory judgment with ancillary relief requiring a lessor to consent to a proposed transaction.[120] Because a traditional motion for summary judgment can be filed immediately after a defendant's appearance, a motion for summary judgment on a lease setting forth objective factors could be prepared, filed, and heard within a relatively short period of time. [121] Protracted litigation over reasonableness could take much longer, and the results are much less predictable.[122]

C. Termination

Texas courts strictly interpret restrictive provisions against the lessor who seeks forfeiture or termination of a lease.[123] A lessor may only seek forfeiture of a lease when the lease contains a specific clause expressly providing that remedy—termination for failure to obtain consent—not a general lease termination clause for a breach of the lease.[124] If a lease requires a right of notice before the declaration of forfeiture, the notice must be

115. *See id.*

116. *See* Pletz v. Standard Homes Co., 342 S.W.2d 621, 621 (Tex. Civ. App.—San Antonio 1961, no writ).

117. TEX. CIV. PRAC. & REM. CODE ANN. §§ 37.001–.011 (West 2015).

118. *See* Cryder & Larkin, *supra* note 9, at 96–97.

119. *See id.*

120. *See id.*

121. TEX. R. CIV. P. 166a(a).

122. *See* Cryder & Larkin, *supra* note 9, at 97.

123. *See, e.g.*, Vinson Minerals, Ltd. v. XTO Energy, Inc., 335 S.W.3d 344, 354 (Tex. App.—Fort Worth 2010, pet. denied).

124. *Id.*

"literally complied with."[125] The notice must be clear and unambiguous.[126] When notice of breach is required under a lease, lessors cannot claim forfeiture without giving lessees the benefit of notice and an opportunity to remedy the default.[127] Operators view forfeiture claims extremely unfavorably. Thus, while a litigator may believe a forfeiture claim provides additional leverage, it often results in greater tension between the parties and decreases the odds of a favorable resolution.

IV. DRAFTING SOLUTIONS TO NEGOTIATION IMPASSE

Both lessors and lessees are advantaged by a requirement that any consent provision requires written consent.[128] While in many consent to assignment contexts the major consideration a party faces when negotiating the provision is whether a consent requirement should be imposed on the lessee, it is almost never a consideration that a lessor must obtain the lessee's consent prior to the lessor's assignment.[129] The parties can negotiate either a one-sided provision in favor of the lessor or lessee or a more reciprocal clause.[130]

The addition of three words to a typical oil and gas lease consent to assignment provision resolves many issues, for both the lessor and lessee, relating to consent to assignment provisions and provides an equitable solution to negotiation impasse:

> "That the rights of the parties hereto shall not be assigned without the written consent of the other parties, which consent shall not be unreasonably withheld*, conditioned, or delayed*."[131]

By requiring that consent not be unreasonably (1) withheld, (2) conditioned, or (3) delayed, a lessee is protected from a lessor who simply either refuses to consent by delay or attempts to renegotiate for greater consideration by conditioning consent.[132] A lessor invoking the consent provision for its intended protective purpose (e.g., avoiding insolvent or ineffective operators) is protected because the lessor could demonstrate the reasonableness of such withheld consent.[133]

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125. *Id.* (quoting Coastal Oil & Gas Corp. v. Roberts, 28 S.W.3d 759, 763 (Tex. App.—Corpus Christi 2000, judgm't vacated w.r.m.)).

126. *Id.* at 358.

127. *Id.* at 354.

128. *See* Cryder & Larkin, *supra* note 9, at 59.

129. *See id.*

130. *See id.*

131. *See* Palmer v. Liles, 677 S.W.2d 661, 663 (Tex. App.—Houston [1st Dist.] 1984, writ ref'd n.r.e.) (Authors' suggested language in italics).

132. *See* Cryder & Larkin, *supra* note 9, at 91–92.

133. *Id.* at 91.

A. Obtaining Lessor Parity and Avoiding Lessor Pitfalls

1. The "Any Reason" Clause

A lessor may seek to avoid a reasonability requirement altogether.[134] One way a lessor may do that is by allowing the lessor to refuse consent for "any reason."[135] Unless a lessor has an extremely high amount of leverage,[136] such a clause might prove a deal breaker because the lessor's arbitrary consent diminishes predictability and essentially terminates the lessee's ability to transfer its leasehold.[137] As discussed earlier, the lack of an articulated standard is equivalent to the inclusion of an "any reason" clause in that both will allow a lessor to arbitrarily withhold consent.[138]

A diminished value in the leasehold affects not only the lessee's interest: a lessee may actually be willing to accept onerous conditions—but in insisting on such conditions, a lessor could very well act counter to its own economic interests by diminishing what lessees will pay (by bonus or royalties).[139] This is acutely true in the instance of an any reason clause, which so substantially diminishes the value of the leasehold that the loss in consideration a lessee may be willing to pay for such a lease easily outweighs the return of the lessor's arbitrary refusal to consent to an assignment. By comparison, if a lessor truly seeks to protect its economic interests by a standard reasonableness requirement, the impact on lease value is minimal; yet the lessor remains just as protected from potential harm from a troublesome assignment.[140] For both the lessor's and the lessee's benefit, the any reason clause should be retired to the annals of history.

2. Avoiding Ratification, Waiver, or Estoppel

Lessors should be concerned whether they can continue to collect royalties after they have objected to an assignment or refused a consent to assignment.[141] Without the inclusion of language to the contrary, acceptance of royalties can operate as a ratification or waiver, or estop a lessor from pursuing a remedy when damaged by a lessee after withholding consent.[142]

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134. *Id.* at 92.

135. *Id.*

136. For example, a lessor might own a combination of either a large mineral estate, a prime surface location, or an important geologic location, particularly in a hypercompetitive leasing environment. *See id.*

137. *See id.*

138. *See supra* Part II.A.1.

139. *See* Cryder & Larkin, *supra* note 9, at 60–62.

140. *See id.* at 91–99 (discussing the reasonableness requirement as it pertains to leases).

141. *See id.* at 103–04.

142. *See* Fortune Prod. Co. v. Conoco, Inc., 52 S.W.3d 671, 678–80 (Tex. 2000); *see also* Samson Expl., LLC v. T.S. Reed Props., Inc., No. 09-13-00366-CV, 2015 WL 6295726, at *8 (Tex. App.—Beaumont Oct. 22, 2015, no pet. h.) ("Samson discusses its defenses of waiver, ratification, and estoppel

It is also not uncommon for an operator–lessee that transfers its interest to an assignee–operator–lessee to maintain accounting responsibilities for a transition period—a lessor, therefore, might unknowingly accept royalties for a period of time that are being paid by the assignee.[143] While it is not uncommon for leases to contain a provision allowing lessors to accept royalties without such acceptance operating as a waiver in limited situations, such as when a lessor underpays royalties, the consent to assignment provision may not typically be considered or included.[144] To allow a lessor to continue to collect royalties while a dispute over the consent to assignment is resolved, lessors should consider adding an unenumerated waiver clause or additional language particularly identifying the consent to assignment provision as one in which acceptance of royalties does not operate as a ratification, waiver, or estoppel:[145]

> Lessor's acceptance of royalties shall not act as a ratification, waiver, or estoppel of Lessor's right to seek any remedy for any covenant, express or implied, provided herein.

Another frequent issue arises when one party argues that, once the other party has consented to an assignment, the consenting party has waived his or her right to refuse consent to any future assignments of the same lease.[146] This argument is an appeal to common law known as *Dumpor's Case*.[147] Importantly, no authority under Texas law recognizes this oft-maligned doctrine.[148] Nevertheless, it is common to address this concern solely for clarity with the following language:

> This provision shall be a continuing requirement regardless of the number of times this lease or any interest therein is assigned.

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as a single group as if the three theories are all based on the same elements; its brief does not address the elements of the defenses, which are not identical, separately. Consequently, we interpret Samson's argument regarding these defenses as asserting a defense of quasi-estoppel, a doctrine that 'precludes a party from asserting, to another's disadvantage, a right inconsistent with a position previously taken.' 'The doctrine applies when it would be unconscionable to allow a party to maintain a position inconsistent with one to which the party acquiesced, or from which the party accepted a benefit.'" (internal citations omitted) (quoting Lopez v. Muñoz, Hockema & Reed, L.L.P, 22 S.W.3d 857, 864 (Tex. 2000) and Cimarron Country Prop. Owners Ass'n v. Keen, 117 S.W.3d 509, 511 (Tex. App—Beaumont 2003, no pet.))).

143. *Cf.* G. Brian Wells et al., *Restraints on Alienation in Coal Leases*, *in* 33 ENERGY & MIN. L. INST. 538, 569 (2012) (discussing a case in which lessor waived rights under an assignment clause because she knowingly accepted royalties from assignee for years).

144. *See* Cryder & Larkin, *supra* note 9, at 103–04.

145. *See id.*

146. *See id.* at 105–06 (explaining this problem, which implicates the rule in *Dumpor's Case*).

147. *See* Dumpor's Case (1578) 76 Eng. Rep. 1110; 4 Coke 119b.

148. *See* Cryder & Larkin, *supra* note 9, at 105–07. As of this writing, a LexisNexis search for "Dumpor's Case" in Texas returned zero case results.

3. Require Additional Information

In order to fully assess the reasonability of a proposed assignment, lessors may want to add a requirement that lessees provide a certain minimum level of information before they are required to provide consent.[149] This could be achieved as such:

> "That the rights of the parties hereto shall not be assigned without the written consent of the other parties, which consent shall not be unreasonably withheld*, conditioned, or delayed, provided that Lessor is supplied with the following information: name of assignee; net worth of assignee; past production of assignee; standing with Texas Railroad Commission permit status; assignee carries specified insurance (for example, worker's compensation, pollution insurance, blowout insurance, umbrella coverage); value of assets currently operated by assignee; and/or operations planned by assignee.*"[150]

As mentioned earlier, as a practical matter, much of this information (e.g., production history and standing with the Railroad Commission) is available in publicly filed documents with the Railroad Commission, and a lessor's best practice is to require only information that cannot be obtained publicly.[151] Non-publicly traded entities may be reluctant to disclose net worth, but enough information should be available in a Form 10-K to satisfy a lessor as to a publicly traded company's ability to perform.[152] With oil and gas leases, a proper balance may be struck by requiring only disclosure of the name of the assignee, insurance, or other lease requirements given a lessor's access to vast quantities of data.

4. Require Minimum Level of Objective Standards

One common proposal is setting a minimum net worth of a proposed assignee.[153] Typically, consent requirements under such provisions are expressly disclaimed for wholly owned subsidiaries or affiliates of a lessee with a certain net worth.[154]

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149. *See id.* at 97.

150. *Id.*; *see also* Palmer v. Liles, 677 S.W.2d 661, 663 (Tex. App.—Houston [1st Dist.] 1984, writ ref'd n.r.e.) (Authors' suggested language in italics).

151. *See supra* notes 83–84 and accompanying text.

152. *Form 10-K*, U.S. SEC. & EXCHANGE COMMISSION, http://www.sec.gov/answers/form10k.htm (last visited Nov. 9, 2015) (public companies are required to disclose information on a Form 10-K).

153. *See* Cryder & Larkin, *supra* note 9, at 96–97.

154. *Id.*

> Without limiting the foregoing, a Lessor's withheld consent is defined as reasonable under any of the following circumstances: [choose] assignee's net worth does not equal or exceed $___; assignee does not have a production history longer than ___ years; assignee has not produced a minimum of ___ BBLs over the prior year; and/or assignee operates at least $___ million in assets in the State of Texas.

5. Bar Assignment to Competitor

In some very specific instances, a lessor may be concerned with a competitor acquiring an interest by assignment.[155] Though rare, a lessor who is concerned with the potential that a competitor (or a specific party) could acquire an interest can include language to exclude certain entities.[156] The lessor should be sure to include language barring not only a named competitor but also broad limiting language providing that the competitor's parents, affiliates, subsidiaries, partnerships, joint ventures, and related companies are also barred from ownership.[157]

> The rights of the parties hereto shall not be assigned to [competitor], its parents, affiliates, subsidiaries, partnerships, joint ventures, and related companies.

6. Include a Lease Termination Provision

A lessor may seek to include a specific lease termination provision, including a notice provision allowing the lessee an opportunity to cure alleged defects in obtaining proper consent.[158] As discussed above, such provisions will be strictly construed against forfeiture, so any termination provision should be exceedingly detailed.[159] The inclusion of any such provision may greatly diminish the value of the leasehold, create unnecessary uncertainty, and increase potential litigation costs because the provision becomes an additional clause for the parties to fight over in the face of cases strictly construing against forfeiture.[160]

7. Limit Remedies for Failure to Consent

A lessor may want to include a clause limiting the remedies for wrongful denial of assignment. In particular, a lessor may be concerned about damages

155. *See id.* at 99.
156. *Id.*
157. *Id.*
158. *See supra* Part III.C.
159. *See supra* Part III.C.
160. *See supra* Part III.C.

assessed when consent that a lessor believes is reasonable may later be adjudicated unreasonable.[161] Thus, a lessor may limit a lessee to declaratory judgment or specific performance to avoid risking a potentially large damages award.[162]

> The exclusive remedies for Lessor's unreasonably withheld consent are declaratory judgment and specific performance.

8. Prevent Circumvention by Change of Control Provision

To prevent circumvention of the consent to assignment provision by the Texas two-step, a lessor can include a lease provision requiring lessor consent when a change in control through merger, acquisition, or conversion occurs.[163] Such a result could be obtained by including the following language immediately after the consent to assignment provision:

> Any change in ownership or control of this lease, whether by merger, acquisition, conversion, or otherwise, is deemed an assignment for the purpose of the previous provision.

The following lengthier solution has likewise been suggested to avoid this result:

> "'[A]ny change in ownership or control of lessee or any of its parent, affiliate or subsidiary organizations as represented to lessor on [date of agreement] is a change in control' and 'change in control' could then be defined as . . . [a] transfer to any entity not . . . sharing the same ownership structure . . . ."[164]

B. Addressing Lessees' Predictability Concerns

1. Negotiate Favorable Objective Standards

Establishing express objective standards increases predictability. Lessees should consider the inclusion of objective minimum standards when it appears during negotiation that a difficult lessor may seek to arbitrarily withhold consent in the future.[165] As suggested earlier, the inclusion of at

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161. *See, e.g.*, B.M.B. Corp. v. McMahan's Valley Stores, 869 F.2d 865, 869 (5th Cir. 1989) (applying Texas law).

162. *See supra* Part III. Additionally, a lessor may consider barring recovery of attorneys' fees.

163. *Cf.* Tenneco Inc. v. Enter. Prod. Co., 925 S.W.2d 640, 645–46 (Tex. 1996) (noting that a merger will not trigger a preferential rights provision but that the lessor could have "included a change-of-control provision in the agreements" that would have).

164. Cryder & Larkin, *supra* note 9, at 79 n.155.

165. *See supra* Part IV.A.4.

least one minimum standard can benefit a lessee by enabling swift resolution where a lessor subsequently unreasonably refuses to consent.[166]

2. Include Expedited ADR Provision Limited to Reasonability

Another method to speed resolution is to include a provision requiring expedited alternative dispute resolution proceedings on the issue of reasonability.[167] A very limited arbitration proceeding (particularly with a selected arbitrator) on the issue of reasonability, limited to a specific time period, may facilitate assignment.[168]

> The parties agree to the submission of solely the issue of whether withheld, conditioned, or delayed consent is unreasonable to binding arbitration under the Texas Arbitration Act, applying Texas substantive law. The issue of reasonability shall be determined by a sole Arbitrator, [name arbitrator or mechanism for selection, e.g., mutual agreement]. A limited written discovery period terminates after four (4) weeks from the date of engagement of the Arbitrator (the "Arbitration Date"). Affidavits in support of dispositive motions must be submitted to the opposing party within five (5) weeks of the Arbitration Date. Dispositive motions must be submitted to the Arbitrator within six (6) weeks of the Arbitration Date. The Arbitrator shall issue a final determination by written findings of fact and conclusions of law within eight (8) weeks of the Arbitration Date. No hearing shall be had except to resolve discovery disputes, which shall be submitted to the Arbitrator for prompt resolution and awards of attorney's fees as appropriate. Evidence in the proceeding is governed by the Texas Rules of Evidence, and no evidence shall be considered unless it is submitted to the opposing party within the time period stated above. The party in whose favor the Arbitrator rules shall be entitled to reasonable and necessary attorney's fees.

3. Deem Consent After Notice

Lessors have taken advantage of notice of assignment provisions, commonly found in sophisticated oil and gas leases, to enforce their rights with respect to consent, even absent proof of damages.[169] A typical notice of assignment provision might read:

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166. *See supra* Part IV.A.4.

167. *See* Frank G. Evans, *The ADR Management Agreement: New Conflict Resolution Rules for Texas Lawyers and Mediators*, HOUS. LAW., Sept.–Oct. 2007, at 10, 11.

168. *See id.* at 12–13.

169. *See, e.g.*, Trafalgar House Oil & Gas Inc. v. De Hinojosa, 773 S.W.2d 797, 798–99 (Tex. App.—San Antonio 1989, no writ).

> "In the event of assignment, LESSEE, its successors and assigns, shall give notice of the fact of such assignment and the name and address of the assignee within thirty (30) days after such assignment; and, LESSOR shall likewise be notified upon each subsequent assignment. Upon each failure of the LESSEE, its successors and assigns to comply with the foregoing 'notice of assignment', said LESSEE, his successors and assigns shall jointly and severally forfeit and pay unto the Lessor the sum of ONE THOUSAND AND NO/100 ($1,000) DOLLARS as liquidated damages."[170]

Construing this notice provision, the San Antonio Court of Appeals upheld an award of liquidated damages against a lessee and its assignees to pay lessor $1,000 for each failure to comply with the notice provision.[171]

The primary economic harm a lessee may suffer under a consent to assignment provision when seeking to assign an oil and gas lease is a lost sale due to a lessor's unreasonably withheld consent.[172] And while in theory a lessee can subsequently redress damages incurred by an unreasonable lessor, a lessee faces a very practical problem: a lessor may be unable to pay a judgment if its failure to consent resulted in a large lost sale.[173] Further, a lawsuit naturally results in increased risk and decreased predictability—it is not often clear-cut whether a lessor's withheld consent is reasonable.

To address these concerns, when lessees are concerned about the potential for future lost sales (for example, when a lessee is promoting an area rather than intending to operate), lessees should take note of lessor-advantage damage provisions and avail themselves of a notice provision.[174] In these situations, the inclusion of language in a notice of assignment provision is appropriate, providing that a lessor is deemed to have consented to the assignment if the lessor does not object within a specified period of time from the date of the lessee's notice. For example:

> If within fourteen (14) days of receipt of notice, Lessor does not object in writing by registered mail or certified mail (return receipt requested) clearly articulating Lessor's reason for withholding consent, Lessor is deemed to have consented to the assignment.

The addition of this or similar language tailored to a lessee's specific needs can provide additional protection from a lost sale by ensuring that the lessor not only objects in writing but that the lessor actually articulates the reason

170. *Id.* at 799.
171. *Id.* at 799–800.
172. *See supra* notes 19–20.
173. *See infra* notes 175–76.
174. *See infra* 175–76.

for the objection.[175] A lessee can assess the reasonability of a lessor's claim, and either proceed with the sale or pursue other relief (e.g., injunctive relief) with greater predictability than the lessee would otherwise be afforded.[176]

V. CONSIDERATIONS IN OTHER OIL AND GAS CONTRACTS

While this Article has focused on oil and gas leases in particular, below is a brief discussion of common oil and gas contracts likely to contain consent to assignment provisions.

A. Joint Operating Agreements

Multiple mineral interest owners ("co-tenants or holders of interests in a common area or geologic formation") use Joint Operating Agreements (JOAs) to designate one party to act as an operator for the area covered under the JOA.[177] JOAs detail the rights and liabilities of each of the parties to the area covered by the JOA.[178] JOAs often "restrict[] the transfer or encumbrance of a participant's interest . . . subject to the JOA by requiring the consent of the other parties to the JOA."[179] The primary motivating concern for requiring consent under a JOA does not significantly depart from the motivation of the parties to an oil and gas lease: JOA parties will want greater control over who they do business with.[180] But the ability for JOA parties to obtain financing is a concern of overriding importance, and a "grant of an encumbrance on one participant's interest could affect financing for the interest as a whole."[181] While the concern over control remains the same, both parties to a JOA share that concern.[182] JOA consent to assignment provisions therefore significantly depart from oil and gas lease consent to assignment provisions in that they are mutual, not asymmetrical.[183]

JOAs frequently except transfers to affiliated entities from the scope of transfer restrictions and consent requirements, which, as in the leasing context, makes sense when an affiliated entity is functionally equivalent to the original JOA party.[184] When a JOA party may need to encumber its interests to a lender to obtain financing relating to the venture, parties should consider excepting such restrictions from the scope of consent requirements

175. *See supra* notes 19–20 and accompanying text.
176. *See supra* notes 140 and accompanying text.
177. Cryder & Larkin, *supra* note 9, at 81.
178. *Id.*
179. *Id.*
180. *Id.*
181. *Id.*
182. *See id.* at 81–82.
183. *Id.* at 84.
184. *See id.* at 82.

to avoid damaging all of the participants to the venture.[185] But any such exceptions should be tailored to the strict and narrow exception contemplated by the parties—allowing a party to only encumber its own interest under the JOA, requiring the secured creditor's interest to be subject to the other terms of the JOA, and subordinating the secured creditor's interest upon foreclosure or enforcement to the interests of the other parties.[186] Narrowly tailoring these exceptions is important to prevent any unintended consequences from defeating the purpose of a consent to assignment provision.[187]

Another concern that operators face is that an operator may not have any recourse against a subsequent bona fide purchaser when an original JOA party assigns its interests.[188] To ensure that JOA parties are not left without a remedy in the event a subsequent bona fide purchaser obtains an interest covered by the JOA from a JOA party, one commentator suggests amending standard AAPL Form 610-1989 Model Form Operating Agreement assignment language in Article XV(B) as follows:

> "Notwithstanding any provision hereof to the contrary, no party shall assign or otherwise transfer all or any portion of any oil and gas interest or oil and gas lease now or hereafter subject to this agreement without first obtaining the written consent of [all the parties] [a majority in interest of the other parties], whose consent shall not be withheld unreasonably."[189]

B. Area of Mutual Interest Agreements

Area of mutual interest agreements (AMIs) are agreements in which parties agree to share leases acquired within a particular geographic area to ensure that every party to an operating agreement has an opportunity to acquire its proportionate ownership interest in any subsequently acquired interests.[190] AMIs may be separate agreements or a part of a larger agreement (typically JOAs, farmout agreements, or seismic contracts).[191] Courts have held AMIs to be both covenants running with the land that bind successors and assigns,[192] and personal covenants that do not bind subsequent holders of

185. *Id.* at 83.
186. *Id.*
187. *Id.*
188. *See id.* at 83–84.
189. ANDREW B. DERMAN, THE NEW AND IMPROVED 1989 JOINT OPERATING AGREEMENT: A WORKING MANUAL 121 (1991) (alterations in original).
190. 15 PATRICK H. MARTIN & BRUCE M. KRAMER, WILLIAMS & MEYERS, MANUAL OF OIL AND GAS TERMS 54 (2012); Allen D. Cummings, *Old Area of Mutual Interest and Dedication Agreements—New Problems*, 52 ROCKY MT. MIN. L. INST. § 27.01 (2006) (citing Westland Dev. Corp. v. Gulf Oil Corp., 637 S.W.2d 903, 905 (Tex. 1982)).
191. MARTIN & KRAMER, *supra* note 190, at 54–55.
192. *See Westland Oil Dev. Corp.*, 637 S.W.2d at 910–11.

the underlying lease.[193] The distinction largely turns on whether the AMI agreement includes successor and assigns language.[194] AMIs often contain consent provisions to ensure that all parties within the AMI maintain a bargained-for interest, although they more typically grant a right of first refusal to purchase the interests of a party seeking to transfer all or a portion of its interests subject to the AMI.[195]

C. Seismic Contracts

"Agreements regarding the license and use of seismic data" frequently include consent to assignment provisions (or other transfer restrictions) "because the value of seismic data is directly related to its confidentiality"—it "is only valuable to the extent that others do not have access to it."[196] Typical seismic license agreements result in a company, which has produced a proprietary seismic survey, "licens[ing] the use of the survey to another exploration company or contractor."[197] "Without a restriction on transfer, the license is considered freely assignable," which (absent restriction) would diminish or destroy the value of the survey.[198]

Because, as discussed earlier, Texas law does not classify the transfer of contract rights under a merger as an assignment, a change in control provision requiring licensor consent to merger is *essential* to the licensor.[199] Otherwise, a party may simply utilize the Texas two-step to avoid assignment restrictions.[200]

D. Service Agreements

Operators alone cannot perform every operation necessary to produce oil and gas; it is crucial to oil and gas operations that an operator rely on services provided by third parties.[201] Importantly, a particular contractor is typically chosen because of its particular skill or expertise.[202] Thus, an operator views its relationship with a particular contractor as indispensable.[203] Accordingly, operators would naturally want to be unilaterally

193. *See* Grimes v. Walsh & Watts, Inc., 649 S.W.2d 724, 726–27 (Tex. App.—El Paso 1983, writ ref'd n.r.e.).

194. *See supra* Part II.A.4.

195. Cryder & Larkin, *supra* note 9, at 85.

196. *Id.* at 86–87.

197. *Id.*

198. *Id.*

199. *See supra* Part IV.A.8.

200. *See, e.g.*, TXO Prod. Co. v. M.D. Mark, Inc., 999 S.W.2d 137, 139–43 (Tex. App.—Houston [14th Dist.] 1999, pet. denied); M.D. Mark, Inc. v. Nuevo Energy Co., 988 S.W.2d 463, 465 (Tex. App.—Houston [1st Dist.] 1999, no pet.).

201. Cryder & Larkin, *supra* note 9, at 89.

202. *Id.*

203. *Id.*

protected from a contractor's assignment.[204] Because of the relationship, "a unique body of law governs service contracts"—including rights and duties under service contracts that cannot be transferred, even absent a provision requiring consent to assignment or other restriction on transfer.[205] An analysis of assignments for service contracts is outside the scope of this Article, however, an operator may be served by the inclusion of an express consent to assignment provision should an operator foresee the potential for assignment.[206]

VI. CONCLUSION

Even though consent to assignment provisions are frequently found in oil and gas leases, practitioners are left with little formal legal guidance. But because of the potential for enormous risk shifting and substantial lost sales, these provisions require greater scrutiny than drafters have historically placed upon them.

Where there is a restriction on assignment, lessees must include some standard to avoid the lessor having unfettered discretion to refuse consent. A clear and concise statement of a restriction and standard is beneficial for both parties. An operator looking to maintain liquidity in his or her asset, increase certainty, and prevent unfavorable outcomes should consider a standard beyond a simple reasonableness standard. Based on a variety of particular concerns between a lessor and lessee, there are a number of drafting choices to be made. Drafters need to discuss with their client their goals for assignment restrictions and standards.

204. *See id.*
205. *Id.* (citing HOWARD O. HUNTER, MODERN LAW OF CONTRACTS § 21.13).
206. *Id.*