

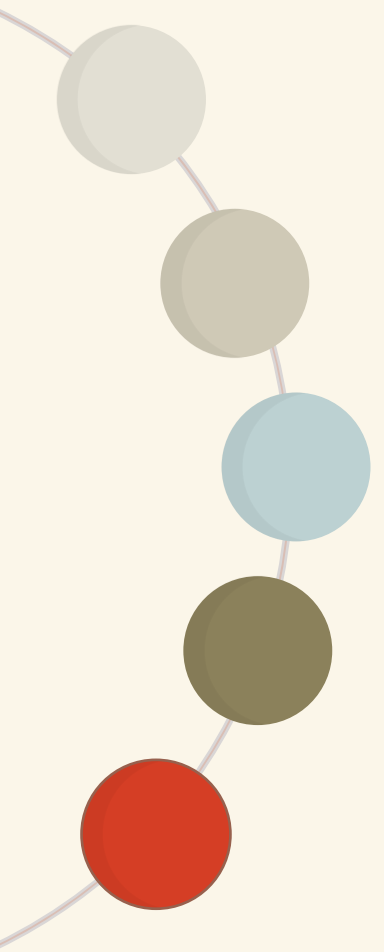
OG Energy Education Series

# It's Okay to Say No Consents to Assign and Preferential Rights

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# Overview

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- I. Consents to Assign
  - II. Hard Consents
  - III. Soft Consents
  - IV. Preferential Rights and Rights of First Refusal

# Consents to Assign

# Consents to Assign

- ❖ Hard vs. Soft Consent to Assign
- ❖ Generally, not considered a material term to the contract.

# Barrow-Shaver Res. Co. v. Carrizo Oil & Gas, Inc., 590 S.W.3d 471 (Tex. 2019)

- ❖ Dispute arises in the context of a farmout agreement between Carrizo and Barrow-Shaver, in which Barrow-Shaver, as the farmee, would earn a partial assignment of Carrizo's interest in exchange for drilling a producing well.
- ❖ As negotiations progressed, the parties focused on the consent to assign provision.
- ❖ Carrizo struck the language that Carrizo could not unreasonably withhold its consent
- ❖ Laufer (on behalf of Carrizo) made multiple statements and assured Bertram (Barrow-Shaver) that Carrizo would provide its consent to assign.

## Barrow-Shaver Res. Co. v. Carrizo Oil & Gas, Inc., (Cont.)

- ❖ The final consent to assign provided:
  - “The rights to [Barrow-Shaver] under this Letter Agreement may not be assigned, subleased or otherwise transferred in whole or in part, without the express written consent of Carrizo.”
- ❖ Barrow-Shaver spent \$22 million drilling an unsuccessful well and was subsequently approached by Raptor Petroleum, which offered \$27 million to Barrow-Shaver for its interest
- ❖ Barrow-Shaver was unable to obtain Carrizo’s consent and the deal with Raptor fell through.
- ❖ Barrow-Shaver sued Carrizo for breach of contract, fraud and tortious interference with contract.

# Barrow-Shaver Res. Co. v. Carrizo Oil & Gas, Inc., (Cont.)

## ❖ Barrow-Shaver's argument:

- Because the consent to assign was silent as to the basis on which Carrizo may withhold its consent, the jury must hear evidence of industry custom and usage to determine whether Carrizo breached the contract.

## ❖ Carrizo's argument:

- The consent to assign provision was not silent, but clearly imposed a hard consent obligation and that Carrizo could withhold its consent for any reason.

## Barrow-Shaver Res. Co. v. Carrizo Oil & Gas, Inc., (Cont.)

### ❖ The Court explained:

- “The farmout agreement indicates that the parties agreed to how consent must be given: consent must be express, and it must be in writing. The contract contains no other consent requirements—it does not impose a deadline for consent to be given, it does not require that it be notarized or signed by a particular individual, nor does it prescribe a specific format for the consent, except that it be written and express. To the extent that the farmout agreement does not reflect any additional requirements as to Carrizo’s consent, the absence of such language indicates there are no other qualifiers, and ‘[l]ack of clarity does not create an ambiguity.’”
- ❖ The purpose of a farmout agreement is to define the farmee’s obligation to drill on the land to complete the transfer of interest – a consent to assign provision is not material.

## Barrow-Shaver Res. Co. v. Carrizo Oil & Gas, Inc., (Cont.)

- ❖ Within a consent to assign provision, “additional terms are not material when the agreement is sufficiently definite to understand the parties’ obligations.”
- ❖ Even if a contract is unambiguous, a court may still consider the surrounding facts and circumstances to aid in construction of the contract.
  - The parol evidence rule, however, bars consideration of evidence that contradicts, varies or adds to the terms of an unambiguous written agreement. Evidence of prior or contemporaneous agreements is inadmissible.
- ❖ The evidence relating to the negotiations (and assurances) between the parties is barred by the parol evidence rule.

## Barrow-Shaver Res. Co. v. Carrizo Oil & Gas, Inc., (Cont.)

- ❖ Barrow-Shaver further asserted that the provision's silence made evidence of industry custom and usage admissible to construe the consent to assign provision
  - Professor Bruce Kramer (Barrow-Shaver's expert) opined that the factors to deny consent involved looking at the financial and technical expertise of the party and the party's reputation. In his opinion, Carrizo's departure from those standards was contrary to industry custom and practice.
  - Attorney K. Ray Campbell (Carrizo's expert) opined that industry custom would allow Carrizo to withhold its consent without specifying a reason because the farmer has the right to refuse to take the risk of dealing with a particular farmee-assignee.
  - Amici submitted briefs in support of Carrizo's position
- ❖ The Court concluded that evidence of industry custom and usage (like evidence of surrounding circumstances) cannot be used to add, alter or change the agreed terms in the contract.

## Barrow-Shaver Res. Co. v. Carrizo Oil & Gas, Inc., (Cont.)

- ❖ The Court declined to impose a duty of good faith and fair dealing on the parties.
- ❖ The Court rejected Barrow-Shaver's argument that "the consent to assign provision cannot mean that Carrizo can prevent an assignment for purely illegitimate reasons that amount to extortion."
- ❖ Barrow-Shaver's fraud argument failed because Barrow-Shaver "could not justifiably rely on any assurances of consent when the farmout agreement's consent-to-assign provision directly and unambiguously addressed consent to assign."

## Mayo Found. For Med. Educ. & Research v. BP Am. Prod. Co., 477 F. Supp. 3d 522 (N.D. Tex. 2020)

- ❖ In the 1990s, the Lips executed an oil and gas lease with Alpar Resources that contained a provision that reserved an absolute veto over any assignments of Alpar's interest.
- ❖ Subsequently, the Lips interest was conveyed to the Mayo Clinic and Alpar's interest to Amoco and the original lease consent to assign was amended:
  - “The rights and obligations of the Lessee hereunder are not assignable or transferable in any respect by it, except upon the written approval of Bank One Trust Company, N.A., as Agent, or any successor agent, which approval shall not be unreasonably withheld.”
- ❖ After the amendment, “the Alpar Lease moved forward at a steady pace, without drastic interruption, mimicking the movement of the cattle, the horses and the horsehead pumpjacks in the Panhandle.”

## Mayo Found. For Med. Educ. & Research v. BP Am. Prod. Co., (Cont.)

- ❖ In 2019, BP finalized a PSA with Latigo Petroleum. Pursuant to an earlier operating agreement, Courson Oil & Gas, Inc. had a preferential right to purchase its interest.
- ❖ Courson accepted the offer and exercised its preferential right
- ❖ Mayo Clinic had previous negative business dealings and litigation with Courson and advised BP that it would withhold its consent to the assignment to Courson
- ❖ Mayo filed the lawsuit seeking injunctive relief to prevent the sale to Courson

# Mayo Found. For Med. Educ. & Research v. BP Am. Prod. Co., (Cont.)

- ❖ The Court's analysis focused on two questions:
  - “First, given the longstanding and strong presumption in Texas law against restraints on alienation of property and the default presumption that an oil and gas Lessee may freely assign its interests, should the Court lend any weight to the paragraph and recognize as valid Plaintiff's contractual right to withhold consent to assign?”
  - “Second, if Plaintiff validly may withhold consent to assign, is such a refusal to consent “reasonable” in the present case vis-à-vis Courson?”
- ❖ The Court stated that the questions were both issues of first impression

## Mayo Found. For Med. Educ. & Research v. BP Am. Prod. Co., (Cont.)

- ❖ “Texas law recognizes that oil and gas leases are chimeras of contract and property law, but also unmistakably sets forth that these leases are ‘leases’ in name only. Despite their contractual form, oil and gas leases under Texas law convey a fee simple determinable interest in the minerals that are leased.”
- ❖ As a result, the starting point is a rebuttable presumption against the validity of restraints on alienation.
  - The Court noted that “the legal landscape on this question is less populated than the Panhandle tract at issue in this case.”

## Mayo Found. For Med. Educ. & Research v. BP Am. Prod. Co., (Cont.)

### ❖ Three types of restraints on alienation (Restatement (First) of Property):

- Promissory Restraints
  - “Lessee shall not assign this lease without express written consent of Lessor”
- Disabling Restraints
  - “Any assignment made without express written consent of Lessor is void ab initio”
- Forfeiture Restraints
  - “This lease shall terminate in the event it is assigned without express written consent of Lessor”

## Mayo Found. For Med. Educ. & Research v. BP Am. Prod. Co., (Cont.)

- ❖ The Court noted that the original consent to assign likely would not satisfy the requirement that the restraint on alienation not be absolute. The inclusion of “shall not be unreasonably withheld” saved the consent to assign provision from being invalid.
- ❖ Next, the Court addressed whether Mayo’s failure to consent to the Courson assignment was reasonable.
  - “If the Texas jurisprudence on the first question of validity is sparsely populated, the Texas jurisprudence on the second question of reasonableness is absolutely barren. To date, no Texas court has published an opinion delineating or discussing the relevant ‘reasonableness’ factors in a case construing a consent-to-assign clause.”

## Mayo Found. For Med. Educ. & Research v. BP Am. Prod. Co., (Cont.)

### ❖ Reasonableness Factors:

- assignee's solvency and track record on making timely royalty payments
- assignee's industry reputation for honesty and reliability
- assignee's prior working relationship with lessor
- assignee's capacity to operate the leasehold in an efficient manner
- whether assignee is a "lease flipper" that will not actively develop the property
- whether assignee would increase the number of non-cost bearing interests on the property, such as overriding royalties and production payments

❖ Court concluded that withholding consent was unreasonable.

# *Preferential Rights*

# Preferential Right - Overview

- ❖ A contractual provision requiring the owner of the burdened property provide the right holder notice and an opportunity to purchase the property prior to selling the property to a third party
- ❖ Four elements
  - An offer to purchase;
  - An election to sell;
  - Notice to the right holder; and
  - Acceptance by the right holder of the same terms as offered by the third party

# Offer to Purchase

- ❖ The property owner must receive a bona fide offer to purchase from a third party or make a bona fine offer to sell to a third party.
  - Must be an actual firm offer
- ❖ Jones v. Riley, 471 S.W.2d 650 (Tex. App. – Fort Worth 1971) defined a bona fide offer:
  - “Made in good faith”
  - “Legally valid”
  - “One that is intended to create a legal relation when accepted” and
  - “Certain and unambiguous”

## Election to Sell

- ❖ The preferential right is triggered when the owner elect to sell in some objective form, meaning that the property owner is “willing to sell for a definite price and on definite terms.” *Comeaux v. Suderman*, 93 S.W.3d 215 (Tex. App. – Houston [14th Dist.] 2002).
- ❖ Generally, the election to sell is synonymous or contemporaneous with the property owner providing notice to the preferential right holder.

# Notice to Preferential Right Holder

- ❖ The property owner must notify the preferential right holder that it has elected to sell and provide the preferential right holder the first opportunity to purchase the property
- ❖ At this point, the preferential right becomes an enforceable option to purchase the property.
- ❖ Texas law is unclear on the exact details that must be provided to the preferential right holder in the notice, but at a minimum must include the purchase price.
- ❖ If the property owner gives no notice or insufficient notice, then the preferential right holder is under no obligation to act.
- ❖ Notice must be actual; constructive notice will likely not meet the notice requirement.

# Same Terms

- ❖ The preferential right holder's option to purchase must be exercised on the exact same terms as the property owner and the third party.
- ❖ A failure to exercise the option under the same terms is ineffectual and amounts to nothing more than a rejection
- ❖ A preferential right holder should not make any counter-offers or attempt any negotiation of any term that is different from the terms in the proposed sale to the third party.

# Creating a Preferential Right

- ❖ Must comply with the Statute of Frauds
- ❖ Must be supported by consideration
- ❖ Not subject to the Rule Against Perpetuities
- ❖ Preferential Rights and Options to Purchase are not interchangeable.

# What Constitutes a “Sale” to Trigger the Preferential Right?

- ❖ Ordinary conveyances of real property in exchange for value are sales, including the sale of the property as part of a package transaction and execution of an oil and gas lease
- ❖ The meaning of “sale” has been limited to exclude the following:
  - Corporate Transfers – “the sale of a corporation’s stock does not trigger rights of first refusal” *Tenneco Inc. v. Enterprise Prods. Co.*, 925 S.W.2d 640 (Tex. 1996)
  - Transfers to Cotenants – “one co-tenant has the right to sell to another co-tenant without notice to the remaining co-owners and not violate the provisions of the written agreement” *Tex. Co. v. Graf*, 221 S.W.2d 865 (Tex. App. – Fort Worth 1949)
  - Involuntary Transfers – there is no election to sell nor bona fide offer. *Draper v. Gochman*, 400 S.W.2d 545 (Tex. 1966)
  - Transfers by Gift (maybe) – not addressed by Texas courts, but there is election to sell nor bona fide offer

# Preferential Rights as Covenants Running with the Land

- ❖ It is possible that a preferential right may never terminate, unless exercised by the preferential right holder
- ❖ The Texas Supreme Court holds that “a covenant runs with the land when it touches and concerns the land; relates to a thing in existence or specifically binds the parties and their assigns; is intended by the original parties to run with the land; and when the successor to the burden has notice.” *Inwood North Homeowners’ Ass’n v. Harris*, 736 S.W.2d 632 (Tex. 1987)
- ❖ A preferential right is covenant running with the land when”
  - The preferential right is granted to the right-holder, his heirs and assigns; and
  - The preferential right burdens property owned by the owner, his heirs and assigns

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