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UPDATED GUIDANCE ON CONSENT-TO-ASSIGN PROVISIONS IN TEXAS OIL AND GAS LEASES

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For decades it has been standard literature on oil and gas leases to note there is uncertainty regarding how a court may treat the violation of a consent-to-assign provision since, in Texas at least, such instruments are contractual “leases” in name only.¹ Some commentators have advocated for courts to disregard their well-established nature as fee simple determinable property interests and instead, apply ordinary contract law on the basis it would be more fair to and in line with the expectation rights of individual landowners.² Others (such as this author) anticipated courts would be more likely to adhere to traditional real property principles summarized in the Restatements of Property to limit application of—and at times invalidate—a freely negotiated consent-to-assign provision as an improper restraint against alienation.³

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1. See *Natural Gas Pipeline Co. of Am. v. Pool*, 124 S.W.3d 188, 192 (Tex. 2003).

2. See, e.g., Luke Meier & Rory Ryan, *The Validity of Restraints on Alienation in an Oil and Gas Lease*, 64 BUFF. L. REV. 305, 307–08 (2015–16) (arguing that property law “labels ... should not be mechanically applied to resolve the validity of restraints in an oil and gas lease.”).

3. See, e.g., T. Ray Guy & Jason E. Wright, *The Enforceability of Consent-to-Assign Provisions in Texas Oil and Gas Leases*, 71 SMU L. REV. 477 (2018); Mark K. Glasser & Scott Humphrey, *The Assignment of Oil & Gas Leases: Conditions, Constraints, and Consequences*, in *CTR. FOR AM. & INT’L L.*, 62ND ANN. INST. ON OIL & GAS L., at 37-38

A recent decision issued by the Federal District Court in Amarillo appears to be first to weigh in on the debate, although flying a bit under the radar given it was issued in the midst of the ongoing COVID-19 pandemic. The opinion is worthwhile reading if you are an oil and gas practitioner in Texas since—although not binding on a state court where most issues are likely to be hashed out—the analysis provides a well-reasoned path for any court to follow in assessing the enforceability of all types of consent provisions and, further, collects a number of factors to consider in regard to what may make a lessor’s refusal to give consent improper. The court’s opinion will at least give commentators something new to write about going forward.

In *Mayo Foundation for Medical Education and Research v. BP America Production Company*,⁴ Judge Matthew J. Kacsmayk of the U.S. District Court for the Northern District of Texas (Amarillo Division) was called upon to determine—in the context of a preliminary injunction hearing—the enforceability of a consent-to-assign provision. The provision provided the defendant-lessee, BP America, could not transfer its rights to anyone “except upon the written approval” of the plaintiff-lessor, the Mayo Foundation, but with a further condition that such “approval shall not be unreasonably withheld.”⁵ As discussed in a previous article by this author, such consent provisions in a real property context appear to be generally enforceable so long as not exploited to extract a “consent fee” or other unbargained-for compensation.⁶

Turns out, the Plaintiff in *Mayo Foundation* (who acquired its status by charitable devise) had a particular aversion to the existing operator of certain wells, Courson Oil & Gas Inc. Courson happened to have a preferential right of purchase in its operating agreement with BP America and exercised that right when Latigo Petroleum LLC (which, to muddy the water further, was owned in part by the Mayo Foundation) made an offer to purchase the lease from BP America. Courson also apparently had a history of litigation with the Mayo Foundation over their oil and gas issues already. When BP America came calling for lessor consent after Courson stepped in to exercise its preferential rights, the Mayo Foundation naturally declined. For unknown reason, it seems BP America concluded it did not actually need consent as a legal matter either way and so, upon giving notice of its

(2011), available at <https://www.lexology.com/library/detail.aspx?g=d574433a-4d41-4483-9375-6ef6a0e73f11>.

4. 447 F. Supp. 3d 522 (N.D. Tex. 2020).

5. *Id.* at 526.

6. See Guy & Wright, *supra* note 4, at 499-500.

intent to move forward, the Mayo Foundation filed suit seeking an injunction to prevent the sale to Courson. That was the best and perhaps only course of action for the lessor to take since, if waiting to see what transpired, the Mayo Foundation would have then been subject to a host of other defenses like waiver or laches.⁷

At the outset of the opinion, after summarizing the history of the land and somewhat convoluted facts, the court cut through it all to recognize two threshold legal issues: (1) was the consent-to-assign provision even valid at all and, (2) if so, did the Mayo Foundation “reasonably” withhold its consent in the circumstances.⁸ Significant case law on both issues exists for ordinary contracts and landlord-tenant matters, but there is little in regard to what Judge Kacsmaryk called the “chimera” of an oil and gas lease. As he noted vividly: “[T]he legal landscape on this question is less populated than the Panhandle tract at issue in this case.”⁹

Nonetheless the court immediately reached the same conclusion as this author, and others, regarding the source of law for answering the questions: i.e., Texas state courts would look to the Restatements to apply traditional property principles and not ordinary contract law since the chimera at issue is unquestionably a fee simple determinable in Texas.¹⁰

As such, Judge Kacsmaryk went on to rule that, as determined by reference to the RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES § 3.4, comment d (as well as the Texas Supreme Court’s recent pronouncements on interpreting language in certain oil and gas contracts),¹¹ a provision requiring consent which cannot be “unreasonably” withheld is a valid *promissory restraint* because the restriction facially does not bar alienation to *all* possible transferees.¹² Interestingly, although dicta, the court contrasted such a result with the language of the lease when held by the original landowner—stating no assignment could ever be made at all—

7. *See id.* at 495-96.

8. 447 F. Supp. 3d at 529.

9. *Id.* at 530.

10. *Id.*

11. The *Mayo Foundation* court offers a summary on the rules of contract interpretation otherwise applicable to Texas oil and gas leases, which in short can be articulated as: (1) look to plain meaning first; (2) if the plain meaning is ambiguous, apply the canon of construction against surplusage to find an interpretation that harmonizes with the rest of the lease; (3) if still ambiguous, a court may investigate the parties’ intent in drafting; but, (4) it is not appropriate to rely on industry usage or custom to add a nonessential term. *Id.* at 530-31 (citing, among other decisions, the recent *Barrow-Shaver Resources Co. v. Carrizo Oil & Gas, Inc.*, 590 S.W.3d 471, 479 (Tex. 2019)).

12. 447 F. Supp. 3d at 532.

which the judge concluded would likely be an invalid promissory restraint.¹³

Mayo Foundation thus confirms the conclusion of those anticipating that the public policy interests baked into real property law would prevail over individual freedom of contract preferences despite any perceived (or real) unfairness to individual landowners; leading to the following general guidelines as to the various types of consent-to-assign provisions that may be found in an oil and gas lease:

- Promissory restraints (covenants not to transfer) – can be valid or invalid depending on the language, but are not a real hindrance either way given the remedy for breach is damages and, in some cases, they can subject the *lessor* to substantial liability and damages if not acting reasonably.
- Disabling restraints (seeking to “void” a transfer) – are always deemed invalid as a matter of law.
- Forfeiture restraints (elimination of lease rights for violation) – are invalid except in the exceedingly unusual circumstance where a lessor negotiated to prevent one particular company from acquiring the mineral rights and also retained a right of reversion to remedy the violation.

More detail on the nuances, with strategies to consider in various scenarios, can be found in a prior article co-authored with T. Ray Guy published by the SMU Law Review in 2018.¹⁴

After answering the question of enforceability, the *Mayo Foundation* court proceeded on to where virtually none other in Texas has gone before: assessing whether or not consent was reasonably withheld in the context of an oil and gas lease and, if not, the consequences for doing so. As Judge Kacsmayk highlighted further in that regard: “[i]f the Texas jurisprudence on the first question of *validity* is sparsely populated, the Texas jurisprudence on the second question of *reasonableness* is absolutely barren.”¹⁵

13. *Id.*

14. See Guy & Wright, *supra* note 4, at 497-504.

15. 447 F. Supp. 3d at 532 (emphasis in original). That is presumably in reference to oil and gas leases only, as there are well-known standards for what is commercially reasonable in the context of contracts and landlord-tenant leases. See, e.g., 29 WILLISTON ON CONTRACTS § 74:22 (4th ed. 2017) (listing factors and noting: “Denying consent solely on the basis of personal taste, convenience, or sensibility is not commercially reasonable. It is

Searching for guidance, Judge Kacsmaryk looked to case law in other states, oil and gas treatises, and law review articles to determine what factors to consider in deciding whether lessor (the Mayo Foundation) acted reasonably in withholding its consent. The court found the possible factors to consider might include:

- The proposed assignee's (Courson's) solvency and record on making timely royalty payments;
- The proposed assignee's reputation in the industry for honesty and reliability;
- The proposed assignee's prior working relationship with the lessor;
- The proposed assignee's capacity to operate the leasehold in an efficient manner;
- Whether the proposed assignee is a "lease flipper" who will not actively develop the property;
- Whether the proposed assignee would increase non-cost bearing interests, such as overriding royalties and production payments; and
- Possibly, based on one law review article at least, whether the proposed assignee is a competitor of the lessor.¹⁶

In the procedural posture of a preliminary injunction hearing, it was on the plaintiff (the Mayo Foundation) to prove, among other elements, that it was "substantially likely to succeed on the merits of its underlying cause."¹⁷ The court did not say what the burden should be as to the balance of factors but one can presume it would fall on the side of not preventing a transfer from occurring due to the strong bias in Texas against restraints on alienation.¹⁸

also unreasonable to deny consent in order that the landlord may charge a higher rent than originally contracted for, since the lessor's desire for a better bargain than contracted for has nothing to do with the permissible purposes of the restraint on alienation, that is, to protect the lessor's interest in the preservation of the property and the performance of the lease covenants.").

16. 447 F. Supp. 3d at 532-33.

17. *Id.* at 528.

18. *See* Robbins v. HNG Oil Co., 878 S.W.2d 351, 363 (Tex. App.—Beaumont 1994, writ dismissed w.o.j.) ("But it is Hornbook law and an axiomatic rule that restraints on alienation are squarely contrary to public policy and are forbidden and disallowed."); *see*

Considering the evidence submitted in the flurry of pre-injunction filings, Judge Kacsmaryk found the Mayo Foundation did not satisfy its burden to show consent was “reasonably” withheld because, despite the general animosity and litigation history no doubt documented well in its briefings, there was insufficient evidence to legitimately conclude the proposed assignee (Courson) was such an incapable oil and gas operator to justify preventing a transfer on public policy grounds.¹⁹ It could be said, in essence, all the factors identified by the court pertain to that policy interest of making sure real property is put to its highest and best use. Withholding consent simply because one does not like a proposed assignee or for any other individualized purposes—such as extracting a “consent fee” or otherwise exploiting the desire or need of a lessee to transfer its rights to someone who appears willing and able to develop the property rights—is certainly not one of the factors identified in *Mayo Foundation*. Ultimately, the court found only one possible factor “weigh[ed] decisively” in the Mayo Foundation’s favor under the circumstances of that case: Courson could be considered a “direct competitor” of the lessor—at least, in the sense that, the Mayo Foundation was part owner of its preferred transferee, Latigo Petroleum LLC.²⁰ But that was still not enough for Judge Kacsmaryk to pump the brakes on a transfer and wait for further development of the case through litigation because he noted that no other state or federal court had ever adopted such a rule.²¹ Plus, the fact that damages were available, as discussed below, likely factored into the Judge’s thought process. In this author’s opinion, it is extremely unlikely any court would *ever* adopt such a rule either because: (1) *Mayo Foundation* presented a unique factual scenario and (2) allowing consent to be withheld for an entity that has (or takes) an ownership interest in some preferred transferee opens up the door to all kinds of “injurious

also Griffin v. Griffin, No. 10-08-00327-CV, 2010 WL 140383, at *4 (Tex. App.—Waco Jan. 13, 2010, pet. denied) (mem. op.) (noting the principle is considered “well-settled in this state prior to 1909”) (citing Diamond v. Rotan, 124 S.W. 196, 198 (Tex. Civ. App.—Texarkana 1909, writ ref’d) (“That a general restraint upon the power of alienation, when incorporated in a deed or will otherwise conveying a fee-simple right to the property is void, is now too well settled to require discussion.”)); Procter v. Foxmeyer Drug Co., 884 S.W.2d 853, 862 (Tex. App.—Dallas 1994, no writ) (explaining three purposes of restraints against alienation).

19. 447 F. Supp. 3d at 533.

20. *Id.* at 533-34.

21. *Id.*

consequences” for which property law has developed the general presumption against restraints on alienation in the first place.²²

In the end, the *Mayo Foundation* ruling was based not only on a determination that the plaintiff failed to meet its burden of showing a substantial likelihood of prevailing on the merits, but also because it could not prove the second element of a preliminary injunction—that the movant would suffer irreparable harm.²³ Judge Kacsmaryk, with an obvious flair for descriptive writing, noted that damages at law would still be available to the Mayo Foundation even if it turned out Courson were to “cheat Plaintiff on royalties, strip mine the surface, and negligently permit all well heads to rust to dust.”²⁴ That is very much in line with the conclusion from the Restatement that breach of a promissory restraint, as no more than a covenant or promise, is not actually much of a hindrance to accomplishing transfers with or without lessor consent.²⁵

In sum, in this author’s view at least, the decision in *Mayo Foundation* is a thorough and well-written (if not entertaining at times) legal opinion that provides further support for the conclusion that consent-to-assign provisions in Texas oil and gas leases should be treated with respect. It also provides, however, that no lessee or prospective purchaser should necessarily feel constrained to cave into unreasonable demands of a property owner/lessor bent on holding up a transaction due to their own personal whims or desire to obtain additional compensation by way of a “consent fee” or otherwise. The public policy goals of property law prevail over individual contract rights when it comes to Texas oil and gas leases.

22. See RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.4, cmt. c (identifying the following “injurious consequences” as reasons not to enforce a restraint against alienation: (1) “impediments to the operation of a free market in land;” (2) “limiting the prospects for improvement, development, and redevelopment” of the land; (3) “demoralization costs associated with subordinating the desires of current landowners to the desires of past owners;” (4) “frustrating the expectations that normally flow from land ownership;” and (5) placing one party “in a position to take unfair advantage of another’s need or desire to transfer property”).

23. 447 F. Supp. 3d at 528.

24. *Id.* at 535 (citing authority for rights of a lessor to bring “multiple causes for damages ... to be made whole for violation of assorted implied covenants in Texas oil and gas leases”).

25. See Guy & Wright, *supra* note 4, at 490 (concluding the violation of a promissory restraint by transferring without consent “would most likely subject the assignor to damages, which in many instances would be nonexistent with a simple change in identity of the lessee”).