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Gerald F. Slattery Jr.

Amanda Davis Landry

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Understanding Area of Mutual Interest, Preferential Rights and Maintenance of Uniform Interest Provisions in Joint Operating Agreements

Gerald F. Slattery, Jr.
Amanda Davis Landry
Schully, Roberts, Slattery & Marino
New Orleans, Louisiana

I. Introduction

When establishing joint ventures or operations for the exploration and/or production of oil and gas, parties typically enter into written agreements, known as joint operating agreements, designed to direct and manage the myriad of issues raised in these ventures. The joint operating agreement designates an operator, who is authorized to act on the behalf of the nonoperators, and specifies each working interest owner's rights and obligations in the joint operation.¹ Issues addressed by the operating agreement include the potential for future acquisitions of mineral interests in the area and the ability to have some continued control over the parties involved in the development and operation of the property.² In an attempt to accomplish these goals, parties have included provisions in joint operating agreements which govern the ability to alienate and purchase property under the purview of the instant agreement. When drafting these provisions, the parties sometimes use all-purpose language found in sample agreements, which may not address their specific needs and goals in this joint operation. Careful understanding and drafting of these restrictive provisions is necessary to avoid future problems regarding their interpretation and application.

This paper will examine three primary categories of restrictions on acquisition and alienation found in oil and gas joint operating agreements: areas of mutual interest, preferential rights to purchase, and maintenance of uniform interests. A general explanation of the principles and theories behind these provisions and their inclusion in joint operating agreements will first be discussed. Then the pros and cons of including these restrictions in joint operating agreements will be explored. Next, this paper will analyze the potential dangers parties face if they blindly incorporate standard joint operating agreement provisions. The paper will conclude with a discussion of the practical and legal problems con-

¹ Larson Operating Co. v. Petroleum, Inc., 84 P.3d 626, 631 (Kan. App. Ct. 2004).

² Harlan Albright, *Preferential Right Provisions and Their Applicability to Oil and Gas Instruments*, 32 S.W. L.J. 803, 804 (1978).

cerning these restrictive provisions addressed by the courts in both Texas and Louisiana, as well as selected case law from other states.

II. General Principles

A. Area of Mutual Interest

Generally, area of mutual interest provisions (“AMIs”) will not be included in joint operating agreements.³ The AAPL model form does not even contain an AMI provision. But when properly drafted and incorporated into a joint operating agreement, an AMI can be a beneficial provision. An AMI grants each party to the operating agreement the opportunity to acquire a proportional interest in each other party’s acquisitions of additional property within the area encompassed by the AMI. This area may include property located around the contract area, or may extend above and below the area of operations in anticipation of future acquisitions or unitizations.

The primary purpose of an AMI is to afford those parties who are mutually funding the exploration and development of the contract area the benefits of these activities, jointly and proportionately.⁴ The AMI thus prevents one of the parties from utilizing the data obtained through the joint development for its own personal gain.⁵ In addition, the AMI promotes cooperative behavior among the parties by limiting competition among them to acquire additional leases surrounding the contract area.⁶

Except for the fact that AMI provisions affect the acquisition and not the disposition of property, AMIs are analogous to preferential rights to purchase provisions in operating agreements. Under an AMI, the acquiring party is obligated to offer the to-be-purchased property within the described AMI perimeter to the other parties to the agreement in proportion to their interest. This is typically accomplished by giving notice of the acquisition and its terms to all other parties to the joint operating agreement, who then have an option for a stated time to elect to participate in the acquisition and reimburse the optionee his share of the acquisition costs.⁷ The offer becomes a bilateral contract of sale only when and if accepted by the optionee in the manner and within the time pre-

³ Gary B. Conine, *Property Provisions of the Operating Agreement – Interpretation, Validity, and Enforceability*, 19 TEX. TECH. L. REV. 1263, 1345 (1988).

⁴ *Id.* at 1345 n.322. See also Dante Zarlengo, *Area of Mutual Interest Clauses Regarding Oil and Gas Properties: Analysis, Drafting and Procedure*, 28 ROCKY MTN. MIN. L. INST. 837, 839-40 (1983).

⁵ See Conine, note 3 *supra*.

⁶ Terry I. Cross, *The Ties That Bind: Preemptive Rights and Restraints on Alienation That Commonly Burden Oil and Gas Properties*, 5 TEX. WESLEYAN L. REV. 193, 215 (1999).

⁷ See *J-O’B Operating Co. v. Newmont Oil Co.*, 560 So.2d 852, 856 (La. App. 3d Cir. 1990) (costs of seismic program conducted by sublessee held part of acquisition costs to be reimbursed by electing participants).

scribed. The specifics of the required form of notice, as well as those governing acceptance, are guided by the AMI provision. Failure to provide the prescribed notice can invalidate it, while failure to transmit acceptance can terminate the option rights at issue.⁸ Parties should take into consideration these and other issues when drafting an AMI, as well as when they are noticing or exercising the option.

B. Preferential Rights to Purchase

In contrast to AMIs, preferential rights to purchase provisions restrict the alienation of a party's interest in a mineral lease. A preferential right, also called a right of first refusal, preemptive right or first option, grants the holder the power to preempt a sale of the burdened property to a third party by invoking the right and matching the purchase price. This preferential right is distinguishable from an option in one key respect: The holder cannot exercise his right until the owner of the burdened property decides to sell.⁹

Preferential right provisions are included in operating agreements and other oil and gas agreements for two primary reasons. First, the provision gives the holder the opportunity, although a contingent one, to acquire future valuable interests in the burdened property.¹⁰ Second, the provision provides the holder some control over with whom he conducts oil and gas operations pursuant to his interest in the joint operating agreement. The holder has the option to purchase the offered interest in order to keep undesirable third parties from participating in the development and operation of the mineral interest.

Although not incorporated into joint operating agreements as frequently as in the past, preferential right provisions are still commonly an issue in the majority of mineral interest and surface property sales.¹¹ Thus, it behooves all parties to become familiar with these provisions and understand how they may affect a proposed sale of a burdened property. The language of the agreement granting the preferential right determines the provision's application to the proposed transaction, with the most common form of the provision contained in the AAPL Model Form Operating Agreement. The 1989 edition of the Model Form, reproduced in the footnotes,¹² essentially requires the seller to provide written notice

⁸ See Conine, note 3 *supra* at 1346-47.

⁹ J. R. Cooney and L. P. Ausherman, *Preferential Purchase Rights in Mineral Agreements*, 37 ROCKY MT. MIN. L. INST. 9-1, at 9-5 (1991).

¹⁰ See Albright, note 2 *supra* at 804.

¹¹ See Cross, note 6 *supra* at 194.

¹² The 1989 AAPL Model Form provision on preferential rights, Section VIII.F, provides:

Should any party desire to sell all or any part of its interest under this agreement, or its rights and interest in the Contract Area, it shall promptly give written notice to the other parties, with full information concerning its proposed disposition, which

of the sale with the name of the buyer, the purchase price, and all other terms of the offer, to the right holder, who then has ten days to respond. The decision to include this model clause or a similar provision in the joint operating agreement should not be taken lightly, considering the difficulties its application may create for both the parties to the agreement and any third-party purchaser.

C. Maintenance of Uniform Interests

Similar to a preferential right provision, a maintenance of uniform interests provision (“MUI”) is commonly included in joint operating agreements to restrict the transfer of interests within the area covered by the agreement. An MUI is considerably broader than the restrictions in a preferential right, and applies to any transfer of interest whether by sale, donation, encumbrance or exchange.¹³ Subject to other restrictions and limitations contained in the operating agreement, an MUI permits a party to dispose of its interest in leases, wells, equipment and production within the covered area only if the transfer disposes of either all the party’s interest or an equal and undivided interest.¹⁴ An MUI protects the investment of the original parties by ensuring that all parties to the agreement will be similarly situated and motivated.¹⁵ The provision also attempts to ensure the smooth functioning of the underlying operating agreement,¹⁶ by reducing the complexity in operations that would result from multiple parties with fractional interests.

MUIs are so common to operating agreements that the AAPL has included a model provision in its form agreement since it was first published in 1956.¹⁷ Although frequently included in operating agreements,

shall include the name and address of the prospective transferee (who must be ready, willing and able to purchase), the purchase price, a legal description sufficient to identify the property, and all other terms of the offer. The other parties shall then have an optional prior right, for a period of ten (10) days after the notice is delivered, to purchase for the stated consideration on the same terms and conditions the interest which the other party proposes to sell; and, if this optional right is exercised, the purchasing parties shall share the purchased interest in the proportions that the interest of each bears to the total interest of all purchasing parties. However, there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to transfer title to its interests to its mortgagee in lieu of or pursuant to foreclosure of a mortgage of its interests, or to dispose of its interest by merger, reorganization, consolidation, or by sale of all or substantially all of its Oil and Gas assets to any party, or by transfer of its interest to a subsidiary or parent company or to a subsidiary of a parent company, or to any company in which such party owns a majority of the stock.

¹³ See Conine, note 3 *supra* at 1326.

¹⁴ *Id.* at 1325.

¹⁵ See Cross, note 6 *supra* at 213.

¹⁶ *Id.*

¹⁷ *Id.* at 212. Section VIII.D of the 1989 AAPL form provides in part:

For the purpose of maintaining uniformity of ownership in the Contract Area in the

arguably they are the most ignored and breached provision in the agreements, and parties generally tolerate these breaches when noted.¹⁸ Parties therefore should seriously consider whether to include these provisions when drafting their operating agreement, focusing on their needs and goals.

III. Pro and Con Considerations of Inclusion in the Agreement

A. The Pros of Inclusion

All three of these provisions have valid and beneficial purposes which advocate for inclusion in a joint operating agreement, and their value should not be discounted. One benefit is that preferential rights, AMIs, and MUIs all restrict, in one form or another, the introduction of third parties to the ongoing operation and development of the covered area. Thus, these provisions give the participants more control over whom they will do business with and to what extent a third party may participate in the joint venture. Preferential rights provisions give the holder the ability to preempt the introduction of an undesirable third party as a co-owner in the operation. By asserting the right of first refusal, a holder can control the identity of his co-owners and exclude parties that may be an economic risk or liability.

Maintenance of uniform interest provisions also help parties exert some control over the addition of third parties in the joint venture. Although MUIs do not give a participant the ability to restrict who may purchase an interest in the operations, they do restrict how many can do so. Since a party may transfer only his entire interest or an equal undivided portion of it, the MUI effectively reduces the number of parties who may opt into the agreement through an assignment of interest. Area of mutual interest provisions limit the ability of a party (perhaps jointly with third parties) to acquire additional leases in the covered area, benefiting from the data collected from joint operations. By requiring parties to offer all acquired interests within the covered area to the co-parties for purchase in proportion to each's share, the provision can restrict a third party from joining in the operations.

Oil and Gas Leases, Oil and Gas Interests, wells, equipment and production covered by this agreement, no party shall sell, encumber, transfer or make other disposition of its interest in the Oil and Gas Leases and Oil and Gas Interests embraced within the Contract Area or in wells, equipment and production unless such disposition covers either:

1. the entire interest of the party in all Oil and Gas Leases, Oil and Gas Interests, wells, equipment and production; or
2. an equal undivided percent of the party's present interest in all Oil and Gas Leases, Oil and Gas Interests, wells, equipment and production in the Contract Area.

Every sale, encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement. . . .

¹⁸ See Cross, note 6 *supra* at 213.

By restricting the number and identity of parties who could be included in the operation, the provisions also bring uniformity to the operation and development of the parties' venture. With this uniformity can come the additional benefit of easing the problems associated with operations. The uniformity in ownership and interests resulting from the MUI and preferential rights provisions insures both administrative efficiency and continuation of the overall design of the operations.¹⁹ The operator is able to complete the determined goals of the participants, as well as the day-to-day operational tasks, without worrying about third parties with contrary interests entering the venture and impeding the completion of the original project. The resulting ease of operation is enhanced by the uniformity of interests maintained by AMIs: Each party has the opportunity to benefit continually in the same percentage as he bore in the initial risk of the project.

AMIs also ease the operation of the joint project by reducing the parties' competition for future acquisitions, since any acquisition of interests in the contract area by one party must be offered proportionally to the others.²⁰ Such cooperation can reduce the cost of operation since the parties are no longer rushed to purchase leases in an attempt to gain a competitive edge.²¹ Finally, the restrictions on the sales of interest in the covered area created by preferential rights and AMIs assure the right holders in the prospect that they can acquire further interests in the covered area if such become available.²² An AMI is of particular benefit when the operating agreement contract area is not fully leased at the time of the agreement, because the provision ensures that each party will have an equal opportunity to acquire additional interests and no participant can obtain an interest to the exclusion of the others.

B. And, the Cons of Inclusion

As in all situations, with the good must come the bad. In addition to the beneficial aspects of these provisions, there are also negative attributes. The most detrimental outcome is the reduced marketability of the property interest resulting from the provisions' restrictions and limitations on alienation. For example, assume Venturer is interested in Property A owned by Seller B, which is subject to a joint operating agreement which grants Owner P preferential rights to purchase. In order to determine the value of Property A, Venturer will invest a substantial amount of time and money in surveys, testing, and evaluations of the property, perhaps including its geophysical and seismic properties. Venturer then offers Seller B \$350,000 for his interest in the property. This offer is ac-

¹⁹ See Conine, note 3 *supra* at 1327.

²⁰ See Cross, note 6 *supra* at 215.

²¹ *Id.* at 215-16.

²² See Conine, note 3 *supra* at 1317.

ceptable to Seller B, but before he can accept and sell the property to Venturer, Seller B must first offer the property to Owner P, the holder of a preferential right to purchase Property A.

Pursuant to the terms of the provision, Seller B gives written notice to Owner P of the offer to purchase, the offeror, the amount and terms. Owner P has ten days to exercise his right of purchase. Venturer and Seller B must wait until Owner P makes his decision or the option lapses. On the tenth day, Owner P contacts Seller B and informs him that he will purchase the property interest at the offer price of \$350,000. Venturer has "made a market" for Property A to the benefit of Owner P, and is left with nothing to show for his investment of time and money except for testing invoices.

This scenario is not far-fetched but rather is a real possibility in purchases involving preferential rights. Given the possible outcome of their efforts, third-party purchasers like Venturer are likely to think twice about investing time and money into a purchase agreement when the subject property is encumbered by a preferential right. Therefore the inclusion of all or any of these three provisions restricting the ability to sell and acquire property may protect the parties to the agreement, but at the cost of reducing the marketability of the property interests.

IV. Drafting Issues: The Dangers of Boilerplate

A. Addressing the Parties' Needs and Narrowing the Scope of Provisions

Another negative aspect to the inclusion of preferential rights, AMIs or MUIs is their potential ambiguity, which can result in problematic interpretations and even protracted litigation. First and most important, when drafting a joint operating agreement, care should be taken in determining whether including any of these restrictive provisions is advisable, and if so, which of them is necessary given the needs and goals of the parties. Using boilerplate language (like that found in the AAPL Model Form provisions) without recognizing the potential consequences can lead to problems in the acquisition and disposition of the property interests. The operating agreement, which will govern the parties' relationship for the span of the operations, should address with particularity those situations likely to arise during the course of the project.

When drafting the agreement and determining whether to include these referenced restrictions on acquisition and disposition of the parties' interests, the parties should determine whether the individual clause is beneficial to the agreement. Preferential rights, although valuable to a party desiring to increase his property interests, do impair the marketability of the property. Additionally, the protection granted by this provision is not fool-proof, and has even been circumvented by parties through

strict reliance on the text of the provision.²³ Therefore if the parties are determined to include a preferential right to purchase provision, they should specify the applicability and conditions of the right. Do they want to restrict the right only to “sales” of the burdened interest, or do they desire to include exchanges of properties as “sales” pursuant to the provision? Would the clause apply to a package sale in which the property is included, and if so, could the right require the purchase of the entire package, as opposed to only the burdened property? The same questions should also arise when deciding whether to include AMIs or MUIs in the joint operating agreement.

When drafting an AMI clause, parties should be sure to use sufficient land descriptions to set out the covered area in order to stem future questions regarding its boundaries. They should also determine whether to limit the term of the provisions and what effect such time limits will have on the operations and the property itself. Most importantly, the parties should recognize that when interpreting these clauses, the courts have indicated that the specific language of the individual restrictive provisions, including preferential rights, AMIs and MUIs, are key to the determination of their applicability.²⁴ Thus, the parties should take extra care in drafting the language of the provision to clearly indicate their conditions and scope.

B. Ambiguity in the AAPL Model Form

As noted above, the AAPL Model Form Operating Agreement, although helpful as a guide when drafting a joint operating agreement, is not without its faults. From its inception in 1956, to subsequent editions in 1977, 1982 and 1989, the AAPL Model Form has attempted to address the practical needs of the parties when entering into a general, or standard, joint operating agreement. Over the years, the AAPL Model Form has addressed those controversial issues pertaining to preferential rights²⁵

²³ See Cross, note 6 *supra* at 230.

²⁴ See *ExxonMobil Corp. v. Valence Operating Co.*, 174 S.W.3d 303, 311-12 (Tex. App. Ct. 2005) (maintenance of mutual interests); *Rainbow Oil Co. v. Christmann*, 656 P.2d 538, 542 (Wy. 1982) (preferential rights); *Courseview, Inc. v. Phillips Petroleum Co.*, 312 S.W.2d 197, 208 (Tex. 1957) (area of mutual interest).

²⁵ See note 12 *supra* for the text of the 1989 AAPL Model Form provision on preferential rights. The 1982 version of this provision, Art. VIII.F, reads as follows:

Should any party desire to sell all or any part of its interest under this agreement, or its rights and interests in the Contract Area, it shall promptly give written notice to the other parties, with full information concerning its proposed disposition, which shall include the name and address of the prospective purchaser (who must be ready, willing and able to purchase), the purchase price, and all other terms of the offer. The other parties shall then have an optional prior right, for a period of ten (10) days after receipt of the notice, to purchase on the same terms and conditions the interest which the other party proposes to sell; and, if this optional right is exercised, the purchasing parties shall share the purchased interest in the proportions that the interest of each bears to the total interest of all purchasing parties. How-

and MUIs²⁶ through marked changes in these provisions.²⁷ However, questions still arise regarding the meaning and interpretation of the provisions and their application to the particular operating agreement.

The preferential rights provision in the AAPL Model Form is the most commonly encountered limiting provision.²⁸ But courts have found it difficult to apply the provision's reference to "sell"²⁹ and to determine when the right is triggered. The AAPL Model Form, in one scholar's opinion, encourages an expansive reading of the term "sale."³⁰ He opines that if the drafters had intended the provision to apply only to "cash sales" of property, then the AAPL would not have had to add exclusionary language regarding the application of the provision in subsequent editions. In interpreting preferential rights provisions, courts have found the term includes package sales³¹ and assignments of overriding royalty rights,³² but not exchanges of interests³³ or foreclosures.³⁴ Parties should be mindful of these issues when incorporating the AAPL Model Form

ever, there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to dispose of its interests by merger, reorganization, consolidation, or sale of all or substantially all of its assets to a subsidiary or parent company or to a subsidiary of a parent company, or to any company in which any party owns a majority of the stock.

²⁶ See note 17 *supra* for the text of the 1989 Model Form provision on MUIs. The 1982 version of this provision, Art. VIII.D, provides in part:

For the purpose of maintaining uniformity of ownership in the oil and gas leasehold interests covered by this agreement, no party shall sell, encumber, transfer or make other disposition of its interest in the leases and Oil and Gas Interest embraced within the Contract Area and in wells, equipment and production unless such disposition covers either:

1. the entire interest of the party in all leases and equipment and production; or
2. an equal undivided interest in all leases and equipment and production in the Contract Area.

Every such sale, encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement. . . .

²⁷ As noted earlier, the AAPL Model Form does not address areas of mutual interest.

²⁸ See Cross, note 6 *supra* at 195.

²⁹ See section IV (B) *supra*.

³⁰ See Cross, note 6 *supra* at 196.

³¹ See *McMillan v. Dooley*, 144 S.W.3d 159 (Tex. App. Ct. 2004) (holding that preferential rights applied to package sale, but that right holder was not required to accept entire package).

³² *IMCO Oil & Gas Co. v. Mitchell Energy Corp.*, 911 S.W.2d 916 (Tex. App. Ct. 1995).

³³ *Panuco Oil Leases, Inc. v. Conroe Drilling Co.*, 202 F. Supp. 108 (S.D. Tex. 1961) (interpreting "drill to earn" agreement).

³⁴ *Draper v. Gochman*, 400 S.W.2d 545 (Tex. 1966). The 1989 AAPL Model Form clarified any confusion regarding the applicability of the provision to foreclosures by expressly excluding these actions from the provision.

provisions into their operating agreement, and should determine whether the specific language of the provision fits their needs and goals.

V. Practical and Legal Problems

A. Area of Mutual Interest

1. *What Transfers Are Subject to the AMI?*

Although the precise language of an AMI provision dictates its applicability to subsequent acquisitions, these provisions are generally broad enough to include almost any acquisition.³⁵ Mineral leases, mineral fees and servitudes, farmouts and subleases are acquisitions of interest which by design may trigger the provision. But what about other transfers of interests?

In *Chevron USA, Inc. v. Phillips Petroleum Co.*,³⁶ the Ninth Circuit determined that the acquisition of corporate stock is not equivalent to acquiring the assets of the corporation, and therefore did not trigger the parties' AMI provision. Similarly, in *Courseview, Inc. v. Phillips Petroleum Co.*,³⁷ the court held that an overriding royalty interest obtained during the course of a valid AMI provision is subject to the preferential right to purchase provision, entitling the right holder to specific performance of the obligation. The rights of assignees³⁸ and acquisitions of property by agents³⁹ have also been adjudicated. Generally AMI provisions will be applied broadly to subsequent acquisitions of interests, and likely will result in subjecting these acquisitions to the right.

2. *Other AMI Issues*

Courts interpreting AMIs have dealt with a myriad of issues, and have recognized that the provisions are governed by the law of contracts. A court's reading of an AMI is thus restricted to the language of the provision and can only be supplemented by extrinsic evidence regarding the parties' intent when the agreement is ambiguous.⁴⁰

In exercising the AMI option, parties elect to participate in the acquisition of the additional interest. Allocation of acquisition costs must be proportionate to each party's share of the additional interest, and includes those costs incurred by the acquiring party as part of the investigation and negotiation of the purchase.⁴¹ Courts have not allowed condi-

³⁵ See Cross, note 6 *supra* at 217.

³⁶ 73 Fed.Appx. 984 (9th Cir. 2003).

³⁷ 312 S.W.2d 197, 200 (Tex. 1957).

³⁸ *Slawson Expl. Co. v. Vintage Petroleum, Inc.*, 78 F.3d 1479 (finding that assignee was right holder pursuant to language of assignment).

³⁹ *Petrocana, Inc. v. William H. Kennedy Consultants, Ltd.*, 595 So.2d 384 (La. App. 3d Cir. 1992).

⁴⁰ See *Kincaid v. Western Operating Co.*, 890 P.2d 249, 252 (Colo. App. Ct. 1994).

⁴¹ See *J-O'B Operating Co., v. Newmont Oil Co.*, 560 So.2d 852, 859 (La. App. 3d

tional elections of this right, requiring parties to elect to participate entirely pursuant to the terms of the agreement, or to be considered to have elected not to participate.⁴² Furthermore, the equitable doctrine of estoppel acts to deny participation to those parties who allege their failure to elect timely was the result of deficient notice, when the party in question has already retained the benefits of the transfer it seeks to nullify.⁴³

3. *Covenants Running With the Land?*

Whether an AMI is a covenant running with the land or is a personal covenant is key in determining its applicability to a successor or assignee. In *Mountain West Mines, Inc. v. Cleveland-Cliffs Iron Co.*,⁴⁴ the district court was required to determine whether an AMI clause was a personal covenant or a covenant burdening the land in order to determine the right to royalty payments. If the AMI ran with the land, the successors of Cliffs would be bound by the clause; if it was personal to the parties, then the successors would not be bound. According to Wyoming law, four elements must be met to establish that a covenant runs with the land: (1) the original covenant must be enforceable; (2) the parties must intend that the covenant run with the land; (3) the covenant must touch and concern the land; and (4) there must be privity of estate between the parties.⁴⁵ The district court recognized that other jurisdictions have found that covenants run with the land, thus binding the successors in interest to the AMI. But the court concluded that no privity of estate existed between the parties and ruled that the covenant at issue was personal to the owner. Therefore the AMI clause did not run with the land and plaintiff could not assert its claim against Cliffs' successors.⁴⁶

B. Preferential Rights

1. *What Triggers the Holder's Right?*

a. Sales and Leases

Section VIII.F of the 1989 AAPL Model Form is the preferential right to purchase provision.⁴⁷ The Model Form indicates that this preferential right is triggered by a party's "desire to sell all or any part of its interests under the agreement."⁴⁸ This definition allows for a broad range

Cir. 1990) (costs incurred in seismic program held to be acquisition costs reimbursable by parties exercising right under AMI).

⁴² *Id.*

⁴³ *Lyle Cashion Co. v. McKendrick*, 204 F.2d 609 (5th Cir. 1953).

⁴⁴ 376 F. Supp.2d 1298 (D. Wy. 2005), *aff'd in part, rev'd in part on other grounds*, 410 F.3d 947 (10th Cir. 2006).

⁴⁵ *Id.* at 1304.

⁴⁶ *Id.* at 1308.

⁴⁷ *See note 12 supra.*

⁴⁸ *Id.*

of interpretations of which actions trigger the right. Generally, a “sale” for the purposes of this provision is defined as “a voluntary, arm’s-length transfer which, if completed, would put the property beyond the reach of the preference right holder.”⁴⁹ This definition naturally encompasses the typical cash sale. Courts’ interpretations, however, suggest that almost any conveyance or transfer “for value” will be considered a “sale” for purposes of preferential rights.⁵⁰ Courts have also held that oil and gas leases and mineral leases are sales within the purview of this provision, triggering the holder’s right.⁵¹ In *Barela v. Locer*, the Texas Supreme Court found that mineral leases convey a property interest, and in fact represent an “acquisition of mineral interests” equivalent to a sale.⁵²

In contrast, transfers which are not accomplished through an arm’s-length transaction and do not put the property beyond the reach of the right holder are not considered a “sale” for the purposes of the right. Gifts,⁵³ donations, and transfers resulting from the death of the owner either by will or intestate succession generally are outside the coverage of the provision and are not considered “sales.”⁵⁴

b. Overriding royalty interests

Some case law supports the view that a transfer of an overriding royalty interest is a sale which triggers a preferential right to purchase. In *IMCO Oil & Gas Co. v. Mitchell Energy Corp.*,⁵⁵ the court held that the sale of an overriding royalty interest prompted the preferential right in an operating agreement. In its decision, the court gave weight to an unspecified provision in the operating agreement that expressly provided that any overriding royalty interest created would be subject to the terms of the operating agreement. Since the court’s decision turned on other language in the operating agreement, the precedential weight of this decision is not clear. But if overriding royalty interests do trigger preferential rights, there are implications for employees, independent contractors, and lenders who use overriding royalties as partial compensation or as part of a financing transaction.

c. Sales to Existing Owners, Mergers, and Intra-Company Transfers

The AAPL Model Form provision contains no express language that would exclude a sale to a party who already owns an interest in the con-

⁴⁹ See Cooney, note 9 *supra* at 9-16.

⁵⁰ See Cross, note 6 *supra* at 196.

⁵¹ See *Barela v. Locer*, 708 P.2d 307, 311 (N.M. 1985); *Cherokee Water Co. v. Forderhause*, 641 S.W.2d 522 (Tex. 1982).

⁵² *Barela*, 708 P.2d at 310-11.

⁵³ *Rainbow Oil Co. v. Christmann*, 656 P.2d 538, 544 (Wy. 1982) (transfer of overriding royalty interest to one’s children held gift, not sale).

⁵⁴ See Cross, note 6 *supra* at 196.

⁵⁵ 911 S.W.2d 916, 921 (Tex. App. Ct. 1995).

tract area. But such a sale would not contravene one of the purposes of this provision—the exclusion of unsavory potential owners—and so should not be subject to the provision.⁵⁶

Transfers of interest resulting from mergers are expressly excluded from consideration as sales by the 1989 Model Form provision. In addition, although not expressly excluded by the terms of the agreement, transfers of leased property or other interests to a subsidiary or parent company have been held to be non-triggering actions. In *Creque v. Texaco Antilles Ltd.*,⁵⁷ the Third Circuit concluded that a conveyance of interest from the grantor to his wholly owned corporation did not implicate the provision. First, the court noted that the transaction did not result from an arm's-length dealing between commercially related parties, which alone should preclude the exercise of the right.⁵⁸ Second, the court recognized that rights of first refusal, or preferential rights, are not traditionally triggered where the evidence indicates that the transfer was from one corporation to another owned and controlled by the same interests.⁵⁹ The court held that both of these factors applied to the current transfer; therefore the conveyance did not change ownership or control and did not trigger a right of first refusal.

d. Stock Transfers

In *Fina Oil and Chemical Co. v. Amoco Production Co.*,⁶⁰ a Louisiana appellate court held that the sale of all the corporate stock of a corporation's subsidiary to a buyer was not a transfer of oil and gas lease interests which would trigger the holder's preferential rights option to purchase under the joint operating agreement. Amoco had transferred its lease interests in three fields to a subsidiary corporation, MW Petroleum Corporation, whose total interest in stock was subsequently purchased by Apache Corporation. Fina Oil and Chemical Company, a non-operator interest holder in the three fields, challenged Amoco's transfer and insisted that it had triggered Fina's preferential rights to purchase. The court disagreed with Fina, finding that a transfer to a subsidiary was one of the recognized exemptions to the preferential rights.⁶¹ Amoco's transfer to its subsidiary MW as a consequence of Amoco's self-described internal reorganization was therefore excluded as a triggering sale.⁶² MW's subsequent stock sale to Apache also did not implicate the holder's rights: The court held that a sale of corporate shares is not a sale of

⁵⁶ See *Texas Co. v. Graf*, 221 S.W.2d 865 (Tex. App. Ct. 1949).

⁵⁷ 409 F.3d 150 (3d Cir. 2005).

⁵⁸ *Id.* at 154.

⁵⁹ *Id.*

⁶⁰ 673 So.2d 668 (La. App. 1st Cir. 1996).

⁶¹ *Id.* at 671.

⁶² *Id.* at 672.

assets, since under Louisiana law the individual shareholders own stock in the company, not proportions of the assets of the corporation.⁶³ Therefore no sale or transfer of lease interests by MW had occurred to trigger the preferential right clauses.⁶⁴

e. Exchanges

Whether an exchange of properties triggers a preferential right when the provision does not specifically address the topic is a question with which courts still wrestle. In *Panuco Oil Leases, Inc. v. Conroe Drilling Co.*,⁶⁵ a Texas appellate court held that an exchange of interests between an assignee and subassignee in consideration of the subassignee's agreement to drill the well deeper was not a sale within contemplation of the right of first refusal clause. Similarly, in *LeBreton v. Allain-LeBreton Co.*,⁶⁶ the Louisiana Third Circuit Court of Appeal determined that a right of first refusal in a partnership agreement was not triggered by an exchange of an interest in that partnership for an interest in another. Like the AAPL Model Form, the partnership agreement expressly applied only to "sales." The court noted that the Civil Code defines sales and exchanges differently, with a sale requiring the thing, the price in money, and consent, while an exchange merely requires a giving of one thing for another, without money.⁶⁷ The court concluded that since the transfer was an exchange, it did not fall within the purview of the right of first refusal clause.⁶⁸

f. Involuntary Sales

The express exclusion for foreclosure sales added to the 1989 AAPL Model Form solidified the answer to the primary issue regarding involuntary sales—are foreclosures excluded since they do not fall under the "desire to sell" language of the provision? Although foreclosure sales are now clearly excluded from the preferential rights clause, the issue of involuntary sales still has relevance. In *Benefit Realty Corp. v. City of Carrollton*,⁶⁹ the court held the Church's sale to the city under the threat of condemnation procedures was a forced sale, therefore, Benefit Realty Corporation's right of first refusal never accrued. Since the Church never "desire[d] to sell," the sale never came under the purview of the preferential right provision.

⁶³ *Id.*

⁶⁴ *Id.* at 673.

⁶⁵ 202 F. Supp. 108 (S.D. Tex. 1961).

⁶⁶ 631 So.2d 662 (La. App. 3d Cir.), *writ denied*, 637 So.2d 159 (La. 1994).

⁶⁷ 631 So.2d at 666.

⁶⁸ *Id.*

⁶⁹ 141 S.W.3d 346 (Tex. App. Ct. 2004).

2. *Package Sales*

The issue whether package sales trigger preferential rights is complex. There are several facets to the inquiry into these sales. When the property holder offers to sell, or receives an offer to purchase, a package of properties not all of which are burdened by preferential rights, the question arises regarding what is a sufficient presentment of the offer to the right holder.

In *Fordoche, Inc. v. Texaco, Inc.*,⁷⁰ the United States Fifth Circuit Court of Appeals faced such an issue. Texaco Exploration and Production, Inc. (“TEPI”) had negotiated to sell to a third party a large group of its properties, which it called the “Gulf Coast Package.” Included in the package were properties in the Fordoche Field in Pointe Coupee Parish, Louisiana, which were covered by one of four joint operating agreements. One of these had been executed in 1962, two in 1969, and one in 1995. The preferential rights provisions in the 1969 and 1995 agreements affected only the sale by a party of its interest in “unitized substances,” gas and condensate produced from the leases. The 1962 agreement, by contrast, affected a party’s entire interest in the leases governed by the agreement.

TEPI had given notice to the other parties to the operating agreements, called the “Fordoche Group,” of its intention to sell. Taking the position that the Fordoche Group had not properly exercised its preferential rights in response to the notice, TEPI then proceeded to sell the properties to the third party. The Fordoche Group sued, and TEPI prevailed on a motion for summary judgment. The Fifth Circuit, reversing, held that the notice insufficiently described the proposed sale, insofar as same affected the Fordoche Group’s rights under the preferential rights provisions, in several respects. According to the Fifth Circuit, TEPI’s notice understated the scope of the Fordoche Group’s preferential rights, and did not clearly describe the particular property interests TEPI proposed to sell to the third party. The Fifth Circuit therefore remanded the case to the district court.

If an operating agreement containing a preferential rights provision governs several wells, and a party contracts to sell his interest in all of the wells, may the right holder who receives notice exercise his preferential rights to some but not all of the tendered properties? Not according to the Tenth Circuit Court of Appeals. In *Brown v. Samson Resources Co.*,⁷¹ a party to operating agreement entered into a purchase and sale agreement with a third party to sell several properties. A schedule attached to the purchase and sale agreement allocated values to the various properties, so the purchase price could be decreased if any properties were

⁷⁰ 463 F.3d 388 (5th Cir. 2006).

⁷¹ 229 F.3d 1162, 2000 WL 1234851 (10th Cir. 2000) (unpublished opinion).

pulled from the deal because of an exercise of preferential rights. Two wells included in the purchase and sale agreement were subject to a single operating agreement, which included a preferential rights provision. When the right holder was tendered those two properties, it attempted to elect as to only one of them, using the value allocated in the schedule to the purchase and sale agreement.

In the ensuing litigation the right holder prevailed before the district court, but the Tenth Circuit Court of Appeals reversed. The court held that, consistent with the nature of a preferential right, the right holder had to match not only the price, but also the terms and conditions of the third party's offer. The allocation schedule attached to the purchase and sale agreement did not change the conditions that the right holder had to meet:

These provisions do not change the fundamental character of the sale. . . . Huber entered into a proposed sale of both properties together, for a listed price. In order to offer Huber the identical terms, Samson was required to match the offer. . . . Samson was entitled to either accept or reject the offer in its entirety.⁷²

The Tenth Circuit therefore held that the right holder's attempted acceptance varying the terms of the offer was ineffective, and left the selling party free to transfer the tendered properties to the third party pursuant to the purchase and sale agreement.

Another problematic aspect of describing preferential rights-burdened properties in a package sale has been addressed by the Texas Supreme Court. In *McMillan v. Dooley*,⁷³ the court held that the inclusion of leases that were not subject to preferential rights in the package sale offer presented to Dooley did not violate the express terms of the preferential purchase provision.⁷⁴ The court determined that the presentment was sufficient because the property holder made a reasonable disclosure of the terms of the contemplated conveyance.⁷⁵ The fact that the presentment included properties not subject to his preferential rights did not affect its sufficiency.⁷⁶ But the court did conclude that Dooley was not required to accept the other leases in order to exercise his rights.⁷⁷ The court opined that because a right holder is not permitted to expand his right to additional properties, neither would it be proper to require him to accept additional, uncovered properties.⁷⁸

⁷² *Id.*, *4-*5.

⁷³ 144 S.W.3d 159 (Tex. App. Ct. 2004).

⁷⁴ *Id.* at 177.

⁷⁵ *Id.*

⁷⁶ *Id.*

⁷⁷ *Id.* at 178.

⁷⁸ *Id.* at 179.

A recent decision by a Texas appellate court, *Navasota Resources, L.P. v. First Source Texas, Inc.*,⁷⁹ addressed several preferential rights issues, some of which relate to package sales. The court analyzed years of case law on rights of first refusal and preferential rights, and rendered an opinion that adds to the lines of authority supporting the following principles:

(i) Once the prospective seller gives notice of his intent to sell, he cannot change the terms of the option for as long as it is open. The right holder, for its part, may only exercise its option in unqualified, unambiguous and strictly compliant terms, accepting all of the terms of the offer. When this acceptance occurs, a binding contract to sell is created.

(ii) A preferential right burdening some but not all of properties included in a proposed package sale may be exercised as to the burdened properties only.

(iii) The right holder cannot be compelled to purchase assets “beyond those included within the scope of the [operating] agreement”⁸⁰ in order to exercise his preferential right.

(iv) Preferential rights generally are not unreasonable restraints on alienation, consistent with the Restatement (3d) of Property, if the procedures for exercising those rights are clear, the time in which they may be exercised is short, and the right to purchase is on the same terms and conditions as the owner may receive from a third party.

(v) A right holder who receives an offer that attempts to impose unwarranted conditions on the exercise of his right should respond promptly by notifying the offeror of his exercise of his actual rights and his objection to the offeror’s attempt to vary them.

Based on *McMillan* and *Navasota*, Texas courts are more likely not to invalidate a preferential right in a package sale context, but would not require the right holder to exercise this right on uncovered properties.⁸¹ Courts in other jurisdictions have also held that the right holder may exercise his right only against the subject property,⁸² even if offered other, non-burdened properties. State courts have yet to come to a consensus on how to balance the right of the holder to exercise his privilege with the right of the property holder to sell his property.

⁷⁹ 249 S.W.3d 526 (Tex. App. Ct. 2008).

⁸⁰ *Id.* at 535.

⁸¹ See also *Riley v. Campeau Homes (Texas), Inc.*, 808 S.W.2d 184 (Tex. App. Ct. 1991).

⁸² See *Maron v. Howard*, 258 Cal.App.2d 473 (1968).

3. Invocation of Right

Once a right holder is given notice of a bona fide offer pursuant to the terms of the right-granting provision, he has a limited time to accept the offer and purchase the property at the offered price and conditions, or will have waived his right to purchase. The information and terms required for a conforming notice are stipulated by the parties in the preferential right provision. If a party does not receive the actual, stipulated notice of the offer, his period for exercising his right should not begin and he should be able to request a conforming notice. But if the right holder is imputed with actual knowledge of the offer despite a nonconforming notice, his right will not continue indefinitely. When the right holder learns of the offer, he has ten days or any other period agreed upon in the provision to give notice of his intent to exercise or waive his right.⁸³ The holder may also be held to have waived any right to acquire the interest sold if he remains silent for an unreasonable length of time.⁸⁴ Lastly, the holder of a preferential right may not compel the property owner to sell until the right is triggered,⁸⁵ but once the right is triggered the holder must exercise his option or risk losing his right.

4. Remedies

Once a court has found that a preferential right exists and has been breached, the issue becomes one of remedies: What remedies are available, and how is the burdened interest valued? Courts generally may choose among specific performance, injunctive relief, or damages, but the choice of remedies will likely be governed by the specific statutes of the situs state. When the property or interest has been offered or sold as part of a package, the task of valuing the burdened interest begins. Courts have generally taken one of three approaches in such circumstances: (1) enjoin the sale and any subsequent sales until the owner honors the provision; (2) order specific performance for the right holder and value the interest according to its percentage of the entire purchase price; or (3) recognize the preferential right and allow the holder to exercise it over the entire package of properties.⁸⁶

C. Maintenance of Uniform Interests

1. Scope of Right

Although the MUI provision has been included in the AAPL Model Form since 1956, the provision is often ignored by the parties, and it is

⁸³ See *Exeter Expl. Co. v. Fitzpatrick*, 661 P.2d 1255 (Mo. 1983) (right holder held precluded from exercising privilege since he did not attempt to exercise same until 15 months after actual knowledge of offer).

⁸⁴ See *Marken v. Goodall*, 357 F. Supp. 317, 320 (D. Wy. 1972).

⁸⁵ *Fasken Land and Minerals, Ltd. v. Occidental Permian Ltd.*, 225 S.W.3d 577, 589 (Tex. App. Ct. 2005).

⁸⁶ See *Albright*, note 2 *supra* at 816-18.

subject to different interpretations.⁸⁷ The provision applies to leases within the covered area, but does it include mineral interests which might become leased and then governed by the operating agreement?⁸⁸ The provision does not give guidance on how to incorporate such interests and case law has yet to address this topic specifically.

Additionally, the legal relationship of the parties to a joint operating agreement varies pursuant to each agreement. Some operating agreements create a co-ownership relationship among the parties by cross-assigning the leases subject to the agreement.⁸⁹ The extent to which an MUI should be applied outside of this scheme has not yet been addressed by the courts. What would result from its application to individually owned leases is not certain, but such application could result in a lack of uniformity of interests due to the nature of the individually owned lease.

2. Interaction With Other Contractual Rights

One reason why MUIs are sometimes ignored by the parties when drafting an agreement and performing the contracted operations may be the negative impact the provision can have on other provisions in the operating agreement. In *Samson Resources Co. v. Amerada Hess Corp.*,⁹⁰ an Oklahoma court held that in order to comply with both the MUI and preferential rights provisions in the context of a package sale offer, the right holder was required to either accept or reject the package as a whole.

Amerada Hess Corporation and Samson Resources Company were parties to three joint operating agreements, all of which contained both preferential rights to purchase and maintenance of uniform interests provisions. In April 1996, Amerada entered into a contract to sell its interest in hundreds of leases to DLB for \$35,028,000. Amerada and DLB had agreed to allocate the purchase price among the assets based on the fair market values.

Pursuant to the preferential rights provision in the three joint operating agreements, Amerada sent three letters to Samson notifying it that Amerada was selling its interest in various wells. In response to two of the letters, Samson elected to purchase only part of Amerada's interest in two of the operating agreements. In its response to the third letter Samson elected to purchase Amerada's entire interest in the joint operating agreement. Amerada responded that it did not consider Samson's elections to be valid. Subsequently Amerada sold its property interests to DLB, and Samson then filed suit against both Amerada and DLB, seek-

⁸⁷ See Cross, note 6 *supra* at 213.

⁸⁸ See Conine, note 3 *supra* at 1326.

⁸⁹ *Id.* at 1326-27.

⁹⁰ 41 P.3d 1055, 1059 (Okla. Civ. App. 2001).

ing specific performance of the preferential rights provision. The trial court granted Samson's motion for summary judgment.

On appeal, Amerada and DLB contended that Samson's attempt to purchase only a portion of the interests under the two joint operating agreements violated both the preferential rights and MUI clauses. Defendants claimed that under the joint operating agreement, Samson was required to either accept or reject all of the offered interests, and that its failure to accept all of the offered interests should be deemed a rejection of all of them.

The court agreed with the defendants, finding that the MUI provisions in the operating agreements constrained the terms upon which Amerada could offer its interests to DLB.⁹¹ The contract to purchase between Amerada and DLB was subject to the MUI clauses, which required Amerada to sell its interest in all the leases or an equal undivided interest in all of the leases.⁹² Complying with the MUI clauses, Amerada had duly offered Samson its entire interest in all the leases.⁹³ The court found that in order to accept the offer, Samson was required to accept the condition and purchase Amerada's entire interests covered by the joint operating agreements.⁹⁴ Since Samson's acceptance was only for a portion of Amerada's interest, the court concluded that it was not a proper exercise of its preferential rights.⁹⁵

Similarly, in *ExxonMobil Corp. v. Valence Operating Co.*,⁹⁶ a Texas appellate court held that a farmout agreement violated the operating agreement's clause on maintenance of interests. The court characterized the farmout agreement among ExxonMobil, Wagner & Brown, Ltd. and C.W. Resources as a transfer or agreement to transfer, thus triggering the maintenance-of-interest provision in the joint operating agreement.⁹⁷ Since the farmout agreement contained depth limitations which restricted the conveyance, the offer did not encompass the entire leasehold portion of the interest, nor did it constitute an undivided interest in the portion.⁹⁸ Therefore the court concluded that ExxonMobil's farmout and offer to assign breached the maintenance-of-interest provision.⁹⁹

⁹¹ *Id.* at 1059.

⁹² *Id.*

⁹³ *Id.*

⁹⁴ *Id.* at 1060.

⁹⁵ *Id.*

⁹⁶ 174 S.W.3d 303 (Tex. App. Ct. 2005).

⁹⁷ *Id.* at 313.

⁹⁸ *Id.*

⁹⁹ *Id.* at 314.

Both the *Samson* and *Valence* courts relied heavily on the MUI provisions' restrictions on alienation in their conclusions. The fact that in *Valence* the MUI provision governed instead of the farmout agreement is not surprising. But it must be noted that in *Samson* the court relied upon the MUI provision instead of basic contract law or the preferential right provision exclusively. Whether courts will continue to find the terms of the MUI provision as the governing law remains to be seen. These two cases indicate that courts are likely to rely on the interpretation of the MUI provisions and find in favor of maintaining the bargained-for uniformity and ease of operation.

D. Other Problems

1. Rule Against Restraints on Alienation and Rule Against Perpetuities

The rules against restraints on alienation and against perpetuities embody judicial policy that agreements that unreasonably restrict free alienability of property are not enforceable.¹⁰⁰ These policies promote full utilization and transferability of land.¹⁰¹ Thus, the determination whether a preferential right, area of mutual interest, or maintenance of uniform interest provision violates the rules against restraints on alienation or against perpetuities is contingent on whether the restraint is unreasonable.¹⁰²

Preferential rights, AMIs and MUIs by definition restrain the free alienability of the subject property. These restraints do interfere with the property holder's right to select to whom he wants to sell, and do discourage third party interest in the property because of the difficulties and restraints placed on the sale. Nonetheless these restrictions are not unreasonable per se.¹⁰³ The generally accepted view is that the restraints placed by these provisions are indirect and ancillary to a legitimate purpose.¹⁰⁴

In *Lawson v. Redmoor Corp.*,¹⁰⁵ the court set out the factors to determine whether a preferential right "unreasonably" restricts alienation: (1) whether the party imposing the restraint has an interest in the land he is seeking to protect by enforcement of the restraint; (2) whether the restraint is limited in effect; (3) whether the enforcement of the restraint accomplishes a worthwhile purpose; and (4) whether the number of persons affected by the restraint is small.¹⁰⁶ Additionally, in *First National*

¹⁰⁰ See Cooney, note 9 *supra* at 9-11.

¹⁰¹ *Id.* at 9-14.

¹⁰² *Id.*

¹⁰³ *Id.*

¹⁰⁴ See Albright, note 2 *supra* at 807.

¹⁰⁵ 679 P.2d 972, 974 (Wash. App. Ct. 1984).

¹⁰⁶ *Id.*

Bank and Trust Co. v. Sidwell Corp.,¹⁰⁷ the Kansas Supreme Court noted that “[t]here are limits on the operation of the rule against perpetuities. . . . A transaction which is exclusively contractual is not subject to the rule against perpetuities.”¹⁰⁸ Courts have continually recognized that restraints on alienation imposed by AMIs¹⁰⁹ and preferential rights¹¹⁰ do not violate the rule against restraints on alienation because these restraints are not unreasonable. However, one court has invalidated preferential rights provisions on the grounds that they violated the rule against restraints on alienation, when the right had no time limit within which the holder was required to act, set forth no procedural guidelines to follow, and required unreasonable concessions.¹¹¹

The rule against perpetuities at common law generally requires that a party have a valid contingent interest in property that must vest within a lifetime.¹¹² Most states have some form of rule against perpetuities. If an option or restrictive right has no time limit, courts generally will try to interpret the right to be valid for a reasonable period.¹¹³ However, if the option or right is intended to be unlimited in duration, then it is void under the rule against perpetuities.

Although the rules against restraints on alienation and against perpetuities are rarely considered violated by preferential rights, AMIs and MUIs, these rules should be considered when drafting and interpreting these rights. One should be cautious not to grant rights that are unlimited in duration, are for a questionable commercial purpose, or that stipulate a fixed price lower than market value.¹¹⁴ If these are avoided when drafting the provisions, the rules should not affect the enforceability of the provisions.

2. Statute of Frauds

Most states treat mineral interests and oil and gas leaseholds as interests in real property.¹¹⁵ Therefore these interests are subject to the rules relating to real property, including the statute of frauds.¹¹⁶ Generally, the statute of frauds requires that an agreement pertaining to the

¹⁰⁷ 678 P.2d 118 (Kan. 1984).

¹⁰⁸ *Id.* at 875.

¹⁰⁹ See *Courseview, Inc. v. Phillips Petroleum Co.*, 258 S.W.2d 391 (Tex. App. Ct. 1953).

¹¹⁰ See *Forderhause v. Cherokee Water Co.*, 623 S.W.2d 435 (Tex. Civ. App. 1981), *rev'd on other grounds*, 641 S.W. 2d 522 (Tex. 1982).

¹¹¹ *Girard v. Myers*, 694 P.2d 678 (Wash. App. Ct. 1985).

¹¹² See *Albright*, note 2 *supra* at 808-09.

¹¹³ *Mattern v. Herzog*, 367 S.W.2d 312, 319 (Tex. 1963).

¹¹⁴ See *Cooney*, note 9 *supra* at 9-14.

¹¹⁵ See *Conine*, note 3 *supra* at 1371.

¹¹⁶ *Id.*

transfer of real property be in writing and signed by the party bound by its terms in order to be effective.¹¹⁷ Although some states do not subject oil and gas leases to the statute of frauds,¹¹⁸ many others do.¹¹⁹ In addition, provisions in operating agreements that involve transfers or assignments of real property interests must comply with the statute of frauds to be enforceable.

In order to ensure compliance with the statute of frauds, parties drafting these provisions must be sure that all blanks are filled and options selected. With respect to the description of the covered area or property, parties should take care to ensure its accuracy, which can be facilitated by incorporating lease descriptions by reference to the original instrument.¹²⁰

3. Recordation and Notice to Third Parties

In addition to the requirements of form which must be followed in order for the instrument creating the right to be valid among the parties, another step is sometimes necessary to enforce the right against third persons. Some states require that notice of the right burdening the property or interest be given to third parties. This is usually accomplished by recordation of the instrument creating the right or of another document prescribed by law. Not all instruments require recordation for notice, but if the instrument does affect rights in real property, it is best to err on the side of recordation.

In Louisiana, the public records doctrine provides that all “sales, contracts and judgments” affecting immovable property¹²¹ are not effective as to third parties until recorded in the public records.¹²² This doctrine is grounded in Louisiana’s public policy favoring the free use and transferability of immovable property. The Louisiana Civil Code specifically applies the public records doctrine to options, rights of first refusal and contracts to sell immovables.¹²³ Thus in Louisiana, failure to record an operating agreement or declaration¹²⁴ of same in the proper parish records will result in a preferential right, AMI or MUI having no effect on

¹¹⁷ *Id.* Louisiana does not have a statute of frauds per se. However, La. Civ. Code art. 1839 requires that all transfers of immovable property be made by authentic act or by act under private signature, both of which require a signed writing.

¹¹⁸ See, e.g., Tex. Bus. & Com. Code Ann. §26.01.

¹¹⁹ See Conine, note 3 *supra* at 1371.

¹²⁰ *Id.* at 1374.

¹²¹ La. R.S. 31:18 classifies mineral rights as incorporeal immovables.

¹²² La. R.S. 9:2756.

¹²³ La. Civ. Code art. 2629.

¹²⁴ La. R.S. 9:2732.

third parties, even if such parties have actual notice of the unrecorded agreement.¹²⁵

VI. Conclusion

Parties should be watchful when incorporating preferential rights, area of mutual interest, or maintenance of uniform interest provisions into operating agreements. Instead of blindly relying on model contracts available throughout the oil and gas industry, the parties should use these models merely as guides for their own agreements. Before inserting any restrictive clauses in their operating agreement, parties should weigh the risks of their incorporation against the possible benefits of inclusion. If they decide to include any restrictive provision in their joint operating agreement, the parties should tailor the provision to meet their particular needs.

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¹²⁵ Blevins v. Mfrs. Record Publ. Co., 105 So.2d 392 (La. 1958); McDuffie v. Walker, 51 So. 100 (La. 1909).