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Evaluating and Drafting Oil & Gas Lease Assignments

by

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I. INTRODUCTION

The most common transaction affecting title to leased minerals is the "assignment" of rights in the oil and gas lease. Oil and gas leases are the "negotiable instruments" of the oil and gas business; assignments are the documents used to accomplish transfers of lease rights.1/ Although the common form of assignment may appear to be a rather simple document, the respective rights and obligations of the parties affected by the assignment are complex.2/ To properly evaluate or draft an assignment, the attorney or analyst must thoroughly understand the substantive law regarding: the property interests being transferred, the resulting rights and obligations of the lessor, lessee, and transferee, and the local law governing transfer of interests in real and personal
property. Adding to the complexity has been a new body of federal regulatory initiatives that impact the transfer of oil and gas interests.1/

Once the substantive law is mastered, the attorney or analyst must put the law into action for their client through the drafting process. The task is easily stated: transfer rights in the lease from A to B and have A and B agree, in the transfer document, on matters that may affect their respective rights as a result of the transfer. This article identifies substantive issues the attorney or analyst must address to properly evaluate or draft an assignment. This provides a list of matters to address in the assignment to clearly delineate the rights and obligations of each party. It should also provide the basis for each word contained in the assignment.2/ This article also identifies the procedural issues, or technique, for expressing the substantive law in a fashion that will accomplish the client’s goals.3/ The substantive and procedural issues are examined from three perspectives: the lessor, the lessee/transferor, and the transferee.

The ultimate goal is to create a guide to evaluating and drafting assignments which incorporates the "why" with the "how to." If the attorney fully appreciates the purpose of
certain language in the assignment, they can evaluate whether its insertion, removal, or alteration will promote their client's interests. They can also evaluate whether it can be stated in a more effective manner.

II. THE PROPERTY BEING TRANSFERRED

A. Classification of the Leasehold Interest

Classification problems abound when dealing with oil and gas interests. Nevertheless, proper classification of the interest is essential to determine what is required for its proper transfer. For example, Texas follows the ownership-in-place theory: the owner of the land also owns all the oil and gas currently situated within the surface boundaries of the land. Ownership of oil and gas is therefore ownership of a real property interest. In Texas the oil and gas lease creates a possessory interest in real property. Therefore, a transfer of rights in an oil and gas lease should follow rules governing the conveyance of real property.

Contrast the Texas classification with that of Kansas. Although Kansas follows the ownership-in-place theory, it treats the oil and gas lease as creating a profit à prendre. The oil and gas lease in Kansas is classified as
personal property.12/ This would seem to require following the law governing the transfer of personal property to properly assign lease rights. However, regardless of the classification, the oil and gas lease is an interest in, or affecting, land.13/ Therefore, states which classify oil and gas leases as personal property generally have statutes and case law which treat the interest similar to real property for certain purposes, such as recording transfers of leasehold interests.14/

The attorney drafting an assignment must be aware of how the lease is classified in their state and then determine whether the legislature or courts have, in effect, reclassified the interest for certain purposes. For example, after researching Kansas law you discover that the lease, although classified as personal property, is treated the same as real property for recording purposes.15/ However, you immediately face issues in the drafting process that may not be expressly addressed by statute. For example, must the spouse of the lessee join in a transfer of rights in an oil and gas lease?16/ Will silence in the transfer instrument regarding warranties give rise to an implied warranty?17/ Addressing these issues may require statutory construction or consideration of common law concepts based upon the personal/real property status of the oil and gas lease. Once
these issues are identified, the drafting attorney can select protective language and procedures to address, and in most cases eliminate, the issue.

B. Rights Transferred in Conjunction with the Leasehold

1. Tangible Personal Property

Apart from the interest being transferred in the oil and gas lease, for developed leases the assignment may also transfer rights to tangible personal property associated with the lease. For example, the casing, tubing, pump jacks, compressors, tanks, oil in tanks, and equipment used to operate wells on the lease are often an integral part of the transaction. The parties should also consider transfer of logs, files, and abstracts associated with the lease. To ensure the proper mode of transfer is used for this property, we can divide it into three categories: (1) Personal property which is titled, such as a motor vehicle; (2) Personal property which is not titled, such as oil tanks; and
(3) Fixtures.

Typically all of these items will be transferred either through general references in the lease assignment or in a separate document, usually titled a "Bill of Sale." However, for titled property, the transfer may not be effective until the appropriate registration and title documents are processed. Fixtures seldom present a problem because they are generally classified as "trade fixtures" and constitute the personal property of the lessee.\(^{18/}\)

When the transfer includes items of tangible personal property, the lessee must consider the impact Article 2 of the Uniform Commercial Code (UCC) may have on the transaction. Generally a sale of tangible personal property will constitute a sale of "goods" under the UCC.\(^{19/}\) Application of the UCC to the transaction requires special attention when drafting the transfer document. For example, under UCC §2-316 special language and drafting techniques must be employed to effectively disclaim a warranty relating to the transferred goods.\(^{20/}\)

2. Intangible Personal Property

Transfer of the leasehold rights may also require the
concurrent transfer of contract rights associated with the lease. Rights in most developed oil and gas leases will be subject to a number of contractual arrangements designed to facilitate development. For example, the leasehold may be subject to a pooling agreement, operating agreement, gas balancing agreement, gas purchase agreement, and division orders. If the lease in undeveloped, it may still be subject to development agreements and various forms of exploration agreements. Each of these agreements can create lingering rights and liabilities which the parties need to consider in conjunction with the lease transfer.

In most cases the parties merely need to study the agreements so they are aware how they impact the value of the interest being transferred. However, in many cases the parties must audit and allocate accrued rights under various agreements. For example, there may be accrued balancing rights against the transferred interest arising out of a gas balancing agreement. Perhaps a gas purchaser has made take-or-pay payments to the assignor under a gas purchase agreement. Under such circumstances, the gas purchaser may have rights to take gas from the lease in the future to make up for gas it paid the assignor for but was unable to take prior to the assignment.21/ The parties must consider these issues and, when necessary, address them in the appropriate
transfer documents. In any event, the lessee needs to account for such contracts in any warranty against encumbrances it gives on the transferred leasehold.

III. FUNCTION OF THE ASSIGNMENT DOCUMENT

The assignment serves three basic functions. First, it is the operative document that assigns rights and delegates duties between the assignor and the assignee. Second, it allocates liabilities between the assignor and assignee and may create obligations in addition to those imposed by the oil and gas lease. Third, the assignment is used to provide notice to the world that a transfer of an interest in the lease has taken place. Once the functions of the assignment are understood, language and procedures can be designed to ensure each function is achieved.

A. Assignment of Rights and Delegation of Duties

Many assignments are purely an assignment of rights. For example, A may assign to B a right to receive 1/16th of all oil and gas produced under the oil and gas lease. B is assigned an interest in the lease, but is not delegated any duties under the lease. However, note that A has created new obligations which it must discharge with regard to B's
interest. Many assignments will include an assignment of rights and a delegation of duties created by the oil and gas lease. For example, A may assign to B all of A’s rights in an oil and gas lease. B will obtain A’s rights in the lease. B will also assume A’s obligations to the lessor, and perhaps to previous assignees of the lease. The extent of this liability will be determined by examining the underlying lease, previous assignment documents, and the present assignment.

Frequently, the new obligations are created in conjunction with the assignment of lease rights and the delegation of existing lease duties. For example, A may assign to B all of A’s rights in the lease, but retain in A the right to receive 1/16th of all oil and gas produced under the lease. In this situation, B receives the property burdened by new obligations created by A; the obligation to pay A 1/16th of all oil and gas produced under the lease. It also includes a delegation of pre-existing duties to the lessor and previous assignees. For example, B must pay the lessor 1/8th of all oil and gas produced, and there may be others entitled to a share of production carved out of assignments occurring before A’s transfer to B. The scope of B’s obligations to A in this situation are discussed in section VIII of this article. A and B’s obligations to the lessor and intermediate assignees are discussed in section
VII. A proper assignment should anticipate problems associated with these relationships and expressly allocate rights and duties between the parties.

B. Allocating Present and Future Liabilities

A and B, through the assignment process, cannot adjust the rights of the original lessor or previous assignees.27/ Unless they obtain the consent of the party affected, they must deal with the rights of parties as established by the oil and gas lease and any prior assignments.28/ For example, if the oil and gas lease indicates the original lessee, A, will remain liable for any breach of lease covenants, A and B cannot unilaterally alter A's liability created by the lease.29/ However, A and B can agree, in the assignment, that B will perform A's obligations and then provide A with a remedy against B if B defaults.30/

The allocation function of the assignment should focus on two types of liability: (1) Liability for improper performance of oil and gas lease obligations; and (2) Liability for improper performance of obligations under current and prior assignments. Each of these allocations should address existing liabilities and future obligations.31/
These matters are discussed in sections VII and VIII of this article.

C. Notice a Transfer has Occurred

An important function of the assignment is to give notice of the transfer. Since an assignment is a transfer of an interest affecting land, notice is given through the recording system established for real estate transfers. If the transfer is given as security, additional recording requirements may be necessary to perfect the resulting security interest. The primary purpose of recording is to provide constructive notice of the assignee’s rights in the property to subsequent purchasers and encumbrancers. An unrecorded assignment is valid only between the parties to the assignment and those having actual notice of the conveyance. An assignee’s rights in an unrecorded assignment can be defeated by subsequent purchasers or lenders who lack actual notice of the transfer.

It is not uncommon to encounter situations where an assignment is made but not recorded until some future event occurs. For example, A enters into a farmout agreement with B. Although A assigns an interest in the lease to B prior to
B’s drilling on the property, the assignment may be in an unrecordable form. Frequently the assignment is made as part of the farmout agreement, which is not acknowledged and therefore not recordable. A doesn’t want to cloud its title until it is certain B will perform the drilling which is usually a condition to retaining the assigned interest.36/ For tax purposes, the parties desire an up-front assignment to avoid passing the assigned interest after its value has been enhanced by completion of a producing well.37/ An unrecordable up-front assignment would seem to address both problems.

However, B assumes a substantial risk by failing to record the assignment. For example, suppose B completes the well but prior to making the assignment A files a petition for bankruptcy. Under § 544(a)(3) of the Bankruptcy Code, as of the date the bankruptcy petition is filed the trustee possesses the rights of "a bona fide purchaser of real property . . . ."38/ Therefore, the trustee will assert rights in the assigned property superior to B’s rights. The trustee is treated as a hypothetical bona fide purchaser without notice of the unrecorded assignment.39/ Although other sections of the Bankruptcy Code may provide B with some recourse, the goal is to avoid the problem by obtaining a recordable assignment, and recording it, in the first
Recording problems can arise in a much less complex fashion. For example, B agrees to provide A with funds to drill and complete a well. A does not want to transfer B an interest in the property until the well is completed and B has paid its share of drilling and completion costs. Before A provides B with a recordable assignment, A mortgages the leasehold to C and conveys an interest in the leasehold to D. If C and D lack actual notice of the prior assignment to B, the rights of C and D will be superior to those of B. The only way B can effectively protect its interest against the rights of subsequent transferees is to promptly record its assignment. Before an assignment can be recorded, it must meet the requirements set by law for recordation. These requirements are discussed in section V of this article.

IV. RESTRICTIONS ON ASSIGNMENT

The first step in the assignment process should be a careful study of the oil and gas lease to determine whether it contains restrictions on assignment. Absent an express limitation on assignment, the lessee can freely assign rights in the oil and gas lease. General references in the lease,
making it binding on the heirs, successors, and assigns of the parties, are sufficient to constitute express authority to assign.43/ Most modern lease forms are more explicit, providing, for example:

The rights of each party hereunder may be assigned in whole or in part, and the provisions hereof shall extend to their heirs, successors and assigns . . . . "44/

Restrictions on assignment come in a variety of forms.45/ Two types of assignment restrictions frequently used by lessors include:

(1) "This lease may be assigned only with the written consent of the lessors."46/

(2) "That the rights of the parties hereto shall not be assigned without the written consent of the other parties, which consent shall not be unreasonably withheld."47/

Neither restriction will accomplish the lessor's intended goal.

Unlike other lease clauses, such limitations on assignment will be strictly construed against the lessor.48/
The restriction requiring the lessor's written consent for assignment has been held void by some courts as an unlawful restraint against alienation. The major problem with such a clause is it doesn't provide for any sort of reversion, forfeiture, or other penalty in the event the interest is assigned. The second clause offers the lessor little protection unless they can demonstrate damages arising out of a breach of the assignment restriction. Also, under the second clause, the lessor runs a greater risk of liability than does the lessee. If it is subsequently held that the lessor's consent was "unreasonably withheld," the lessor may be liable to the lessee for a lost sale of the assigned interest.

The lessee's strategy in attacking assignment restrictions is straightforward. First, any doubtful language must be interpreted to favor free assignment. Second, restrictions which require the lessor's prior approval can often be attacked either as an unreasonable restraint against alienation, or be subject to a court-imposed standard that the lessor's consent can only be withheld for cause. The lessor's strategy is to avoid creating an unlawful restraint against alienation while providing the lessor with the protection it requires. To draft an appropriate clause, the attorney must be cognizant of the
goals the lessor hopes to achieve through assignment limitations. The lessor’s concerns can be placed into five categories:

(1) The lessor entered into the leasing transaction based, in part, on the reputation, skill, and financial position of the lessee.

(2) The lessor desires to share in any increased value of the leasehold at the time of transfer.

(3) The lessor wants to prevent the creation of excessive noncost-bearing interests in the leasehold which may discourage development.

(4) The lessor wants to know, at all times, the current owners of the leasehold.

(5) The lessor wants to avoid having a large number of transactions affecting record title which will require increased abstracting fees for routine lessor transactions—such as a farm loan requiring an up-dated abstract.

Each of these goals can be achieved through proper drafting.
A. Policing Assignments Through Continuing Liability

If the lessor is concerned the lessee might assign the lease to a fly-by-night operation, perhaps the best protection is to permit assignment but keep the lessee on the hook for any future nonperformance of lease covenants.\footnote{The lease could provide:}

**ASSIGNMENT BY LESSEE**

LESSEE can Assign all or any part of the Lease. However, LESSEE will remain obligated for the proper performance of all express and implied Lease obligations. LESSEE's liability for the non-performance of lease obligations will be in addition to the liability of any assignee obtaining an interest through the LESSEE or any assignee obtaining an interest through LESSEE's assignee. The liability of LESSEE and all assignees transferred an interest in the Lease is joint and several.

This clause contemplates that the terms "Lease" and "Assign" will be defined in the lease. The term "Lease" is defined in the granting clause which contains a description of the leased land. The word "Assign" should be defined to include

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transfers classified as a sublease.\textsuperscript{56} For example:

1. "Assign" and "Assigns" mean:

A written transfer of rights in the Lease, whether technically classified as an assignment or sublease.

2. "Assignment" means:

The written document used to Assign rights in the Lease.

Restraints on alienability are avoided; the interest is freely transferrable. Instead, the lessee, in effect, becomes a guarantor for the performance of all subsequent assignees.\textsuperscript{57} Such a provision seems fair since the lessee has total control over who they permit to own, and to subsequently assign,\textsuperscript{58} the lease. If the lessee desires to limit its liability, it can avoid assignments, assign to responsible operators who agree to indemnify the lessee against any future claims, or seek a release of liability from the lessor before the assignment is made. When seeking a release of liability from the lessor, the lessor should be
able to freely give or withhold its permission to the lessee. The lessor can be "unreasonable" when the issue is a release of continuing liability--as opposed to lessor consent to assign.59/ Presumably the lessor will be "reasoned with" through cash and perhaps the resolution of any current disputes regarding the lessee’s performance under the lease.

If the lessor fails to select a responsible lessee in the first instance, continuing lessee liability will not achieve the lessor’s goal. However, if the liability of subsequent assignees is cumulative, this will at least provide a pool of defendants in hopes of finding one with the ability to perform, or pay damages. The goal is to make any person ever owning an interest in the leasehold jointly and severally liable for the performance of lease obligations. Many states attempt to obtain such a position under their plugging statutes.60/ The current operator has primary responsibility for plugging abandoned wells.61/ If the current operator is unable to respond, prior operators can be held responsible for the current operator’s default.62/ Wording to make subsequent assignees jointly and severally liable could provide:

Any person or entity obtaining an Assignment of rights in the Lease: (1) Is deemed to have accepted liability for the non-performance of any
express or implied Lease obligations accruing prior
to the date of Assignment; and (2) Is liable for
the proper performance of express and implied lease
obligations from and after the date of Assignment.
Liability for the non-performance of lease
obligations will be in addition to the liability of
LESSEE, any assignees obtaining an interest through
the LESSEE, or any assignees obtaining an interest
through LESSEE’s assignees. The liability of
LESSEE and all assignees transferred an interest in
the lease is joint and several.

Such a provision would force the prospective assignee to
make inquiry regarding the lessee’s performance of express and
implied covenants. To be safe, inquiry would have to be
directed to the lessor. This would seem to accomplish a
number of the lessor’s goals. The lessor has an opportunity
to air complaints which the current lessee may be trying to
solve by assigning the interest. The prospective assignee can
evaluate the potential liability presented by the lessor’s
claims and perhaps enter into an agreement with the lessor to
address the claims. This may result in a corresponding
adjustment of the leasehold purchase price. In any event, the
real value of such a provision is the potential that the
lessor’s complaints can be identified and addressed at the
critical pre-transfer stage. Absent such a provision, the new owner of the leasehold interest will be inclined to tell the lessor to deal with the assignor.63/

B. Policing Assignments Through Reversion and Forfeiture

One way to ensure that the interest is not assigned without the lessor’s consent is to provide that the lessee’s rights in the lease will automatically revert to the lessor upon making an unauthorized assignment.64/ To ensure the lessor does not become the owner of a plugging obligation, or some other liability associated with the leasehold, the lessor may want to avoid automatic termination and reversion of the leasehold. Instead, the lessor, when an unauthorized assignment is made, could have the option of declaring the lease terminated. The major problem will be finding a prospective lessee willing to agree to such limitations.

Even if a lessee willing to agree to the limitation is found, it will surely meet with close judicial scrutiny.65/ Therefore, it would seem advisable to eliminate all lessor discretion in the matter. The initial approach would seem to provide for a reversion if the interest is assigned without
"lessee's consent." This invites the court to mitigate the harshness of the reversion by implying that the lessor's consent will not be unreasonably withheld.66/ This problem is eliminated by simply providing that the lease will terminate, and all rights revert to the lessor, if it is assigned. The lessor, however, must carefully define the term "assignment" to ensure all the intended types of assignment are expressly described. For example, is an assignment of an overriding royalty an "assignment" that will trigger the reversion? What about an assignment of the lease as security for a loan? It is likely that absent express language including these types of "assignment" the court would try to limit the clause to assignments of working interests in non-credit transactions.67/

C. Policing Assignments Through Special Requirements

If the lessor has a particular reason for wanting to restrict assignment, perhaps the problem can be resolved in a more direct fashion. For example, if the concern is with increased abstracting fees, the lease could provide:

While this lease is in effect, LESSEE agrees to pay to LESSOR all costs associated with the
preparation of abstracts of title covering all or any part, or any interest in, the LESSOR's land covered by this lease. This obligation relates to any transaction which the LESSOR enters into concerning the sale, lease, or other transfer of the land covered by this lease. The obligation also relates to loan transactions where the land is used as collateral. LESSOR will provide the LESSEE with a copy of the paid invoice showing the abstracting charge and a brief description of the transaction requiring the abstracting services. LESSEE will reimburse LESSOR for the expense within 30 days after receiving the invoice and LESSOR's description of the transaction.

If the lessor is concerned with notice of the transfer, the lease could provide that the assignor will remain responsible for all express and implied lease obligations until the lessor is notified of the assignment. This should be sufficient to encourage prompt notification. If the assignor fails to give the required notice, they would remain jointly and severally liable for non-performance of lease obligations. Lessors usually start looking for the current lessee when there is a problem. The lessor might use a clause
Upon Assignment of all or any part of the Lease, the assignor will provide LESSOR with a certified copy of the recorded Assignment. The assignor will remain liable for the non-performance of all express and implied lease obligations occurring up to and including the date the required Assignment document is given to LESSOR.

This clause assumes the lessor was unable to negotiate the continuing liability of the lessee and all assignees. The general rule, absent a specific lease provision, is that the assignor will be responsible only for events occurring while they owned an interest in the lease. The foregoing clause is designed to expand the time period which the assignor can be held responsible--up to the time lessor is given notice of the assignment.

If the lessor wants to share in the increased value of the leasehold, they may insert a clause similar to the one addressed by the court in Moherman v. Anthony: "If [an interest in the lease is] sold, first party [lessor] to receive one-half of the consideration lease is sold for." The lessor could provide for a flat fee to be paid to the
lessor each time the lease is assigned. If the lessor wants to discourage the creation of nonoperating interests, the lease could provide that lessor will receive a cost-free share of production each time an overriding royalty or other nonoperating interest is assigned out of the leasehold interest. For example, the lease might require that each time a nonoperating interest is assigned to third parties the lessee will assign to lessor a 1/32nd of 8/8ths overriding royalty on all oil and gas produced from the leased land. The term "nonoperating interest" should be carefully defined to include overriding royalties, production payments, net profits interests, convertible interests, carried interests, and any other form of interest where the lessee must, at some time, bear the costs associated with the interest being assigned. A more workable limitation would be to provide for termination of the lease if the lessee's net revenue interest falls below a certain level, for example 75%. This prevents the lease from becoming excessively burdened by cost-free interests that may deter development of the lease.

Many times, if the lessee can identify the lessor's specific problems, a tailored clause can be fashioned to address the lessor's concerns without unduly restricting the lessee's ability to assign. Restrictions on assignment can provide the lessor with effective control over the lessee and
subsequent assignors and assignees. However, the lessor must
draft clearly and refrain from being too zealous in their
restrictions: A simple requirement for lessor consent may
constitute an unlawful restraint against alienation.71/

V. REQUIREMENTS FOR AN EFFECTIVE ASSIGNMENT

Although some states may not classify the oil and gas
lease as a real property interest, it still creates an
interest in land.72/ Therefore, lease assignments should
comply with the same conveyancing formalities required for a
conveyance of real property.73/ To have an effective
conveyance of real property the following matters must be
addressed:

1. Identity of parties to the conveyance;

2. Appropriate words of conveyance;

3. Consideration for the grant;

4. Description of the property being conveyed;

5. The instrument should be in writing and signed by
the grantors;

6. The instrument should be delivered to, and accepted by, the grantee;

7. The instrument should be acknowledged; and

8. The instrument should be recorded.

A. Writing, Parties, Words of Conveyance

Using Texas law for illustration, the details of each requirement can be identified by following the logical sequence in which the assignment is drafted. First, the lease assignment must be in writing. The writing must identify the assignors and the assignees. The words of conveyance should be appropriate for the transfer of an interest in land. For example: "A (assignor) conveys to B (assignee) . . . ." The Texas statutes suggest either the words "conveys" or "grants" as appropriate words of conveyance. Texas Property Code § 5.023 provides, in part:

(a) Unless the conveyance expressly provides otherwise, the use of 'grant' or 'convey' in a
conveyance of an estate of inheritance or fee simple implies only that the grantor and the grantor's heirs covenant to the grantee and the grantee's heirs or assigns:

(1) that prior to the execution of the conveyance the grantor has not conveyed the estate or any interest in the estate to a person other than the grantee; and

(2) that at the time of the execution of the conveyance the estate is free from encumbrances.77/

The Texas statutory conveyance form uses the phrase: "have granted, sold, and conveyed, and by these presents do grant, sell, and convey . . . ."78/ Use of the past tense to describe the transfer is a remnant of the livery of seisin and feoffment process; the actual conveyance being the transfer of a twig or clump of dirt and the deed merely describing, in the past tense, what took place.79/ A simple reference to "A grants to B," or "A conveys to B," is sufficient.80/ In states which classify the oil and gas lease as personal property, a statement that "A assigns to B" or "A assigns and conveys to B" would be sufficient.81/
In states where the assignment of the lease is treated as a conveyance of a fee interest, the assignor must ensure they clearly except any interest they wish to retain. The assignor will be deemed to convey all their interest in the property unless they specifically limit the grant. For example, §5.001 of the Texas Property Code provides: "(a) An estate in land that is conveyed or devised is a fee simple unless the estate is limited by express words or unless a lesser estate is conveyed or devised by construction or operation of law."  

B. Consideration  

Although consideration may not be required for a valid conveyance, it is often required to convey homestead rights or to derive the full benefits under the recording statutes. For example, to obtain priority over prior unrecorded conveyances of the property, the grantee must obtain their interest "for a valuable consideration" without notice of the unrecorded conveyance. Although consideration may be required for a conveyance, it is not necessary to recite the consideration in the conveyance instrument. Courts will look outside the instrument to ascertain whether it is supported by consideration.
However, it would seem proper to use a recitation of consideration.89/

In most states it is sufficient to use a simple statement that "A conveys to B, for valuable consideration . . . ." There is no need to specify the actual consideration paid for the assignment. A reference to "valuable consideration" avoids the use of such phrases as "for the payment of one dollar and other consideration." If there is some other requirement, such as "adequate" consideration,90/ the phrase can be expanded to refer to "valuable and adequate consideration."91/

C. Description

To be effective, the assignment must describe the property being conveyed.92/ A description which identifies the property, or which allows identification by reference to extrinsic evidence, is sufficient.93/ However, a distinction must be made between a description effective between parties to the conveyance, including those having actual knowledge of the conveyance, and persons who lack knowledge of the conveyance. The court applies this distinction in Luthi v. Evans94/ holding an assignment of "all Oil and Gas Leases in
Coffey County, Kansas owned by grantor is sufficient to bind persons with actual notice of the conveyance. However, the conveyance did not adequately describe the property to impart constructive notice.

The assignee will want to protect its rights by preventing the assignor from conveying rights in the same property to a subsequent innocent purchaser or encumbrancer. To achieve this protection, the instrument must (1) be recorded; and (2) specifically identify the affected property by description in the assignment or by reference to other instruments in the recorded chain of title. Although the assignee in Luthi had recorded the assignment, the general reference to the assignor's interests in Coffey County, Kansas did not adequately identify the affected property so as to give constructive notice of the transfer.

Description of the land affected by an assignment is normally accomplished by reference to a governmental survey or recorded plat, or by a metes and bounds description. To the extent possible, the description should coincide with the legal description used in the instrument by which the assignor received its interest. The specific leases subject to the conveyance must be adequately described along with the land
they cover. Normally this is accomplished by stating the legal description of the land covered by the assigned lease followed by the book, page, and county where the lease is recorded. For example, suppose A owns an oil and gas lease covering all of Section 30, Township 36 South, Range 10 East. A wants to convey its lease rights to B. The assignment document could provide:

A conveys to B, for valuable consideration, the following property:

An Oil and Gas Lease between John Doe and Mary Doe as lessor and A as lessee, dated September 15, 1989, recorded in Book 110, Page 179, of the Miscellaneous Records of Eureka County, Kansas, covering all of Section 30, Township 36 South, Range 10 East, from the 6th Principal Meridian, in Eureka County, Kansas.

If the assignment covers a number of leases, the parties may use an exhibit and tabulate the lease and property description information. Problems associated with describing the scope of the interest assigned are discussed in section VI of this article.
D. Delivery and Acceptance

To be effective as a transfer of title, the assignment must be "delivered." To determine if delivery has occurred, the facts and circumstances surrounding the transaction are examined to ascertain the assignor's intention to complete the transfer. The assignee's possession of the assignment and recording of the assignment tend to indicate delivery. Although recitations of delivery may be self-serving, they can, on occasion, have some probative value. Therefore, the assignor may want to conclude the assignment with the phrase: "Signed and Delivered" followed by the date and the assignor's signature.

To complete delivery, the assignee must "accept" the conveyance. When the conveyance is beneficial to the assignee, acceptance is presumed. Apparently, the only way to overcome this presumption is through evidence of the assignee's actual rejection of the assignment. In many situations it is advisable to obtain the assignee's express acceptance of the assignment; especially when the assignee is assuming the assignor's obligations as part of the transaction. For example, if the assignor of a lease is
obligated to drill a well or pay a specified amount to a previous assignor, or the lessor, the assignor's signature could be followed by a statement such as: "Assignment and all related rights and obligations accepted" followed by the assignee's signature. This should avoid problems when the assignee, within a short time following the assignment, purports to reject the grant.101/

E. Acknowledgment and Recording

In section III of this article the importance of recording is discussed. However, before an instrument will be entitled to recording, it must meet a number of statutory requirements. When drafting the assignment, the attorney must ensure all prerequisites for recording are met. Using Texas law for illustration, Texas Property Code § 12.001 states, in part:

(a) An instrument concerning real or personal property may be recorded if it has been acknowledged, sworn to with a proper jurat, or proved according to law.

(b) An instrument conveying real property may
not be recorded unless it is signed and acknowledged or sworn to by the grantor in the presence of two or more credible subscribing witnesses or acknowledged or sworn to before and certified by an officer authorized to take acknowledgements or oaths, as applicable.¹⁰²/

Although § 12.001 provides for the alternative of signing before two witnesses, and then having the conveyance "proved,"¹⁰³/ most conveyances are acknowledged by the grantor before a notary public. Texas Property Code § 11.002 requires the instrument to be stated in the English language.¹⁰⁴/ § 11.003 suggests that the conveyance instrument contain the mailing address of each grantee.¹⁰⁵/

Sections 121.001 to 121.014 of the Texas Civil Practice and Remedies Code address the requirements for proper acknowledgment of a conveyance.¹⁰⁶/ § 121.001 addresses who can take an acknowledgment.¹⁰⁷/ In most cases, the acknowledgment will be taken by a notary public. The method of acknowledgment is specified in § 121.004, which provides:

(a) To acknowledge a written instrument for recording, the grantor or person who executed the instrument must appear before an officer and must
state that he executed the instrument for the purposes and consideration expressed in it.

(b) The officer shall:

(1) make a certificate of the acknowledgment;

(2) sign the certificate; and

(3) seal the certificate with the seal of office.108/

§ 121.008 provides for the use of various short forms of acknowledgment which, when properly used, will meet the statutory requirements for acknowledgment.109/ For example, the short form for a certificate of acknowledgment of a natural person provides:

State of Texas
County of___________

This instrument was acknowledged before me on (date) by (name or names of person or persons acknowledging).
This section considers problems associated with identifying the scope and nature of the interest being assigned. Assignments create many of the same interpretive problems encountered with mineral interest conveyances. For example, an assignment of the oil to one party, while retaining the gas and "other minerals," not only requires an interpretation of what is included as "other minerals," it also requires an interpretation of what is "oil." A more common assignment problem concerns the definition of the surface and subsurface leasehold area being assigned. Once the area affected by the assignment is accurately defined, the rights associated with the assignment must be described. For example, what tangible and intangible property rights are included with a grant of the leasehold? What rights will the assignee and assignor have to use the surface, or segregated formations, to develop their respective leasehold interests? After defining the bundle of rights being conveyed, the next problem is to define the type of warranty the assignor is
giving regarding the conveyed property. The final task addressed in this section is to identify, and offer solutions to, problems in quantifying the interest conveyed.

A. Surface and Subsurface Descriptions

1. Surface Description Problems

Suppose A owns a lease covering all of Section 30. A wants to convey to B all of A's rights to the North 1/2 of Section 30, the description task is simple. However, suppose A only wants to convey to B lease rights to the drill site associated with the Farmer 2-30 Well in the North 1/2 of Section 30? The task becomes more difficult. What is a "drill site?" Is it a proration unit, spacing unit, or pooled unit? Is the area defined by current production and well completions? Suppose the existing spacing or proration unit is 40 acres based on oil production from well completions in a reservoir at 2350 to 2400 feet. What if the well is deepened, or gas is discovered in another zone, resulting in spacing on a 160-acre or 320-acre basis? What if the area is down-spaced to 20 acres?

A simple reference to the drill site for descriptive
purposes will not suffice. One solution is to assign a
definite block of acreage associated with the well, such as
the Northeast Quarter of the Northwest Quarter of Section 30.
If a larger area is needed to produce deeper or different
zones, the assignee will need to lease or pool the necessary
acreage. Another solution would be to try and anticipate
potential expansion or reduction of the drill site area and
provide for a corresponding adjustment to the rights assigned.
This seems unadvisable since property rights would be
reverting and revesting in response to new drilling and
conservation commission actions.113/

Equally complex problems arise when the assignment is
limited solely to leasehold rights associated with a specific
well. Suppose B wants to purchase A's rights associated with
the Farmer 2-30 Well. This is called a "wellbore" or
"borehole" assignment.114/ The obvious problem is defining
the rights of the assignee when limited solely to production
from a particular well. Presumably, the assignee would
receive rights in the production allocated to the well by the
conservation commission, even though the assignee does not own
any of the leasehold acreage required to establish the
allowable. So long as the well continues to produce, problems
may not arise. Suppose the well ceases producing. The first
problem the assignee may encounter is whether they have the
right to enter the surface on the lease to access the well. Assuming the assignment transfers the lessee's right to use the surface, what can be done to the well? Can it be recompleted in a new zone? Can it be deepened? Although the assignee may be able to enter new zones within the existing well, it is doubtful the assignee could drill a replacement well. These problems should be weighed when deciding whether a wellbore assignment is advisable. In any event, the drafting attorney must be cognizant of the state regulatory system and anticipate possible problems created by the state's approach to spacing, prorationing, pooling, and unitization.

2. Subsurface Description Problems

Uncertainty is the major problem in describing depth limitations. When dividing the leasehold by depth, commonly called a "horizontal severance," the parties are seldom certain how subsurface rock structures are configured. The area may be heavily faulted, or a producing reservoir may dip. The depth selected by the parties may inadvertently separate rights to a single reservoir. For example, suppose A conveys to B the leasehold rights in Section 30 from the surface down to 5,000 feet below the surface. A retains all leasehold rights to depths below 5,000 feet. If an oil and
gas reservoir underlying Section 30 extends from 4,900 feet to 5,050 feet below the surface, a dispute may arise concerning which party has the right to produce from the reservoir.116/

Similar problems can arise when a specific formation is being conveyed. Suppose A conveys to B the leasehold rights to only the Dakota formation in Section 30. This may avoid the split reservoir problem, but disputes may arise concerning the existence and extent of the Dakota formation. For example, A may claim the base of the Dakota formation is at 5,050 feet but B may argue it is at 5,000 feet. B might argue a formation at 5,500 feet is part of the Dakota formation which has been segregated by a fault.

Such problems demonstrate the need for expert advice from the appropriate technical personnel to ensure the selected depth description is workable. Geological studies of the area may reveal readily identifiable and uniform formations which can be used for depth references; they can also reveal formations which may be difficult to identify. Depth limitations are often defined by referencing the occurrence of the formation in other wells in the area. For example, A could use a nearby well as a "marker well" to indicate the depth a formation is found on a particular log. Suppose A wants to convey its Section 30 leasehold rights in the Dakota
formation to B. A well is located on Section 29 which penetrates the Dakota formation, the Smith 1-29 Well. The sonic log for the well indicates the Dakota formation begins, in the Smith 1-29, at 4,050 feet and ends at 4,100 feet. Due to surface elevation variances and the folding, dipping, or faulting of subsurface structures, it is unlikely the Dakota formation will be encountered at the same depths in Section 30. However, the Smith 1-29 Well measurements provide a reference for log interpretation on which the parties can agree. Examination of sonic logs run on a well drilled in Section 30, exhibiting similar patterns to those observed in Section 29, will aid the parties in resolving disputes over the location of the Dakota formation.

A’s conveyance to B could provide:

A assigns to B the oil and gas leasehold interest created by an oil and gas lease dated 31 July 1985 between Fred Farmer as lessor and A as lessee, recorded in Miscellaneous Book 143 at Pages 17-18 of the Eureka County, Kansas records, to the extent the lease covers A’s leasehold rights to the Dakota formation in Section 30, Township 36 South, Range 10 East from the Sixth Principal Meridian, Eureka County, Kansas.
For reference purposes, A and B agree the Dakota formation is identified by sonic log as beginning at 4,050 feet and ending at 4,100 feet in the Smith 1-29 Well located in the Northwest Quarter of the Northwest Quarter of Section 29, Township 36 South, Range 10 East, from the Sixth Principal Meridian, Eureka County, Kansas.

A excepts from this assignment all leasehold rights to depths and formations in Section 30 above and below the Dakota formation.

Agreements are frequently encountered where a portion of the leasehold interest is assigned to a depth equal to the total depth drilled by the assignee. Many times the depth used is 100 feet below the total depth drilled. To account for the folding, dipping, and faulting of subsurface structures, assignments often grant down to the "stratigraphic equivalent" of a stated numerical depth. For example, drilling terminates in a nonproductive rock strata at 3,000 feet in the Farmer 1-30 Well located in the Southeast Quarter of Section 30. You intend to assign rights to all formations down to the 3,000 foot mark as measured in the Farmer 1-30 Well. Suppose the formation takes a sudden dip or upturn. 3,000 feet below the surface in the Southwest Quarter may put
you into an entirely different rock structure which may be above or below the structure selected in the Farmer 1-30 Well. Instead of merely assigning rights to 3,000 feet below the surface, it is better to select an expression that will reference a specific formation which can be identified anywhere on Section 30; whether found at 3,000 feet in the Southeast Quarter, 3,500 feet in the Southwest Quarter, or 2,500 feet in the Northwest Quarter. This can be accomplished by either identifying a specific formation, or by using a reference well, a stated depth, and assigning to the stratigraphic equivalent of the total depth drilled.117/

Suppose B has drilled a well, the Farmer 1-30, to 3,000 feet and, by contract with A, is entitled to an assignment to the total depth drilled. To ensure B obtains rights to the formations penetrated by its well, and that productive formations are not split, the assignment could provide:

A assigns to B the oil and gas leasehold interest created by an oil and gas lease dated 31 July 1985 between Fred Farmer as lessor and A as lessee, recorded in Miscellaneous Book 143 at Pages 17-18 of the Eureaka County, Kansas records, covering Section 30, Township 36 South, Range 10 East, from the Sixth Principal Meridian, Eureka
County, Kansas, to the extent the lease includes A's interest from the surface down to the stratigraphic equivalent of 3,000 feet beneath the surface, as measured in the bore of the Farmer 1-30 well completed in the Northwest Quarter of the Northwest Quarter of Section 30, Township 36 South, Range 10 East, from the Sixth Principal Meridian, Eureka County, Kansas.

A excepts from this assignment all leasehold rights to depths below the stratigraphic equivalent of 3,000 feet beneath the surface as measured in the bore of the Farmer 1-30 Well.

Another problem is the actual measure used to determine depth. The depth can be measured as true vertical depth or the depth as measured through the drill pipe. Since the drill pipe will always deviate from the vertical to some extent, the depth as measured through the drill pipe will always be greater than the true vertical depth. However, measurement of the drill pipe length would seem the most practical approach. A related problem is where to begin taking the measurement from the surface. Three options are sea level, the rig floor, or the surface.118/
The key to drafting depth limitations is obtaining the necessary technical information. Usually, requests for horizontal severances are encountered in developed areas where the necessary geological and geophysical information is readily available; the attorney's task is to ensure available technical data is used to create a clear and workable division of leasehold rights.

After resolving subsurface description issues, the drafting attorney must deal with surface use problems created by the horizontal severance. Somewhat similar surface use problems are created by drill site and wellbore assignments. In each case, the surface rights of each party should be specifically identified as part of the property associated with the assignment.119/

B. Property Associated with the Assignment

As noted in section II of this article, assignments should convey the leasehold plus all tangible and intangible property rights associated with the leasehold. If the assignment is limited by depth, or to a specified wellbore interest, the assignment should include the surface and subsurface rights necessary to develop the assigned interest. For example, if A is conveying to B only the leasehold rights
to the Dakota formation in Section 30, the assignment should indicate: "B is also conveyed, to the extent necessary to reasonably explore, develop, and operate the assigned interest, the right to enter and use the surface of the leased land and to drill and operate through formations excepted by A from this assignment." A should similarly retain the right to drill and operate through the assigned formation -- the Dakota. For example: "A reserves from this assignment, to the extent necessary to reasonably explore, develop, and operate A's retained leasehold interest, the right to drill and operate through the interest assigned to B." The parties must also consider whether the increased surface use burden falls within the express or implied easement created by the oil and gas lease.120/ If the mineral and surface estate were severed before the lease was entered into, the surface use issue must be determined under the implied easement/reasonable use doctrine -- unless the deed severing the minerals specifically addresses the surface use issue.121/

Assignment of the leasehold interest will not necessarily convey equipment and fixtures associated with the lease.122/ Such items of tangible personal property should be specifically conveyed. For example, the lease could provide: "A also conveys to B all fixtures, equipment, and other personal property located on, and used in conjunction with,
the assigned interest." If a bill of sale is used to convey tangible personal property, the assignment can incorporate the bill of sale for descriptive purposes. For example, the lease could provide: "A also conveys to B all fixtures, equipment, and other personal property located on, and used in conjunction with, the assigned interest, to include items listed in a Bill of Sale between the parties dated September 15, 1989." Although the Bill of Sale may not be recordable, the reference in the recorded assignment should be sufficient to place third parties on notice of the assignee's rights.123/

Generally, intangible rights associated with the assigned interest are listed as exceptions to the warranty. As noted in section II of this article, in some situations the parties need to specifically allocate, and assign, rights under contracts to which the leasehold interest is subject.

C. Warranties and the Assigned Interest

The assignment should specifically state whether the assignor is warranting the assigned interest. If the assignor
desires to convey the lease without warranties, in most cases an express disclaimer of warranties will be required. In states that treat the oil and gas lease as personal property, an assignment of the lease for a fair price implies a warranty of title in the assignor.124/ In states that classify the oil and gas lease as real property, the use of common words of conveyance, such as "convey" or "grant," may imply that certain warranties are being made in conjunction with the transfer. For example, § 5.023 of the Texas Property Code provides:

(a) Unless the conveyance expressly provides otherwise, the use of 'grant' or 'convey' in a conveyance . . . implies only that the grantor and the grantor's heirs covenant to the grantee and the grantee's heirs or assigns:

(1) that prior to the execution of the conveyance the grantor has not conveyed the estate or any interest in the estate to a person other than the grantee; and

(2) that at the time of the execution of the conveyance the estate is free from encumbrances.

(b) An implied covenant under this section
may be the basis for a lawsuit as if it had been expressed in the conveyance. 125/

An assignment of an oil and gas lease may contain a general or special warranty, no mention of warranty, an exclusion of all warranties, or merely quitclaim to the assignee whatever interest the assignor may own. If the assignment contains a warranty, the assignor should carefully except all existing encumbrances, including operating agreements, gas purchase contracts, gas balancing contracts, and rights burdening the leasehold created by prior assignments. If a warranty is given, it is often a "special warranty." A special warranty conveyance normally limits the assignor's covenants of warranty to encumbrances and defects caused by the assignor. The assignor covenants to warrant and defend title against anyone claiming "by, through or under the grantor, but against none other." 126/ However, the special warranty can be tailored in any fashion necessary to meet the needs of the parties to the conveyance. The express terms of the warranty will determine its scope.

Since the assignee's interest depends upon the continuing validity of the oil and gas lease, the assignment sometimes contains specific title covenants concerning the status of the lease. For example, if A has failed to pay delay rentals 127/
or shut-in royalty\textsuperscript{128} when due, the lease may have terminated. If $A$ has failed to operate and develop the lease prudently, it may be subject to cancellation.\textsuperscript{129} If there has been an interruption in production from the lease, during the secondary term, the lease may have terminated.\textsuperscript{130} If $B$ is purchasing an interest in $A$'s lease, $B$ may require $A$ to warrant that the lease is in effect, that all rental, shut-in royalty, royalty, and other payments required by the terms of the lease have been timely made, and that $A$ has the right to convey the interest. The attorney representing $B$ should independently investigate the status of the lease by examining state records, delay rental receipts, shut-in royalty receipts, affidavits of production, lessor demands, surface occupancy, and take whatever additional action is necessary to ensure the assignor has complied with the lease.

Prior assignments should also be examined. For example, in Riley v. Meriwether\textsuperscript{131} the assignment provided:

\begin{quote}
Assignee shall reassign to Assignor, all interest in the [assigned leases] . . . which are not then producing, and upon cessation of production and the plugging of any well on the land above described . . . if said production cessation is for longer than sixty (60) consecutive days and if no drilling
\end{quote}
operations have been commenced on the land within such period.\textsuperscript{132}/

The assignee completed several gas wells pursuant to its farmout agreement with the assignor. The gas wells were subsequently shut in because there was no market for the gas. Shut-in royalty was paid under the leases, but the court holds this does not extend the assignee's rights under the assignment. Since the assignment did not provide for payment of shut-in royalty in lieu of actual production, the assignee's rights terminated automatically when the production condition was not met. The assignment also provided:

Reference for all purposes is made to the oil and gas leases described in Exhibit A attached hereto and incorporated herein by this reference.\textsuperscript{133}/

The court nevertheless holds this did not incorporate the lease terms, such as the shut-in royalty provisions, for purposes of determining the duration of the assigned estate. Therefore, in addition to ascertaining the status of the oil and gas lease, the prospective assignee must ascertain the current status of each prior assignment to ensure their assignor still possesses the rights they are purporting to assign. If the assignee fails to discover a defect in their
assignor’s title, the assignee’s only remedy, absent fraud, misrepresentation, or mutual mistake, will be to seek damages for breach of any warranty contained in the assignment.

D. Quantifying the Assigned Interest

Problems concerning the quantum of interest conveyed out of the leasehold usually involve the creation of nonoperating interests such as overriding royalties and production payments. The owner of the leasehold interest is entitled to a share of production which is determined by subtracting the lessor’s royalty interest. For example, assume the lessor’s royalty is 1/8th of gross production and the lessee is entitled to the remaining 7/8ths of production. If lessee A conveys a 1/16th overriding royalty to B, the conveyance document must clearly indicate how B’s interest is to be calculated. Is it 1/16th of gross production (1/16 x 8/8) or 1/16th of A’s share of production (1/16 x 7/8)? The conveyance should designate how the interest is to be calculated by stating the appropriate fraction by which it will be multiplied. For example, suppose A wants to convey to B 1/16th of A’s share of production. One way to accurately express the interest conveyed is: "A conveys to B 1/16 of 7/8
of 8/8 of production." In this example, B would receive 7/128ths (1/16 of 7/8) of gross production from A instead of 8/128ths (1/16 of 8/8). The fraction 8/8ths is used to indicate gross production; B's overriding royalty is therefore 1/16th of A's 7/8ths share of gross production. If A is required to assign B a 1/16th share of gross production, this can be expressed: "A conveys to B 1/16 of 8/8 of production."

References to the lessee's "working interest" or "leasehold interest" for quantity descriptions should be avoided since these phrases are often used to refer to the lessee's share of gross production. For example, if A conveys to B "1/16 of 7/8 of A's working interest" does B have 7/128ths (1/16 of 7/8) of gross production or 49/1024ths (1/16 of 7/8 of 7/8) of gross production?134/

Suppose A owns only an undivided 50% leasehold interest in Section 30 and conveys to B 1/16 of 7/8 of 8/8 of production from Section 30. Do the parties intend B's share of production to be 7/128ths (1/16 x 7/8 x 8/8) or 7/256ths (1/2 x 1/16 x 7/8 x 8/8)? Under the express terms of the assignment, B will be entitled to 7/128ths of production as opposed to 7/256ths.135/ If A desires to reduce the assigned interest to reflect A's 50% ownership in the leasehold, A can include a "proportionate reduction clause" in the assignment.
The proportionate reduction clause reduces the assigned interest to coincide with A's actual leasehold ownership--in the event A owns less than the entire leasehold interest. The clause should also address B's interest in the event the lease is pooled or unitized with other leases and A's share of production is thereby reduced. A sample clause follows:

To the extent A's leasehold interest in [the assigned property] covers less than 100% [8/8ths] of the mineral interest, B's overriding royalty interest will be reduced in the proportion that A's interest bears to 100% [8/8ths] of the mineral interest.

In the event all or part of the assigned property is pooled or unitized with other leasehold interests to form a drilling, spacing, or proration unit, or to effect fieldwide unitization, B's overriding royalty interest shall be further reduced in the proportion surface acreage covered by the assigned property included within the unit bears to the total surface acreage within such unit.

If unit production is allocated by some formula other than
surface acreage, the clause would have to be amended to incorporate the formula employed.

To quantify B’s interest, the assignment must designate the type of production on which B’s interest attaches. Usually overriding royalty language is similar to the royalty clause of the lease in that B’s interest will attach only to oil and gas "produced and saved from the leased premises." To fully quantify B’s interest, it is also necessary to determine the costs chargeable against the override. The assignment should specify how costs will be allocated between A and B. Usually A will agree to cover all drilling, production, and operating expenses from its share of production but B will be responsible for payment of taxes levied against its share of production. Allocation of marketing costs, such as gas dehydration, treatment, compression, and transportation costs, should always be expressly addressed in the assignment instrument.136/

VII. OBLIGATIONS INCIDENT TO THE ASSIGNMENT

Upon assignment of the oil and gas lease, the assignee becomes entitled to all the assignor’s rights under the lease. In addition to the express rights created by the lease, the
assignee is entitled to any implied rights which the lease relationship may confer upon the lessee. For example, in Mai v. Youtsey the court notes that each of the lessee’s partial assignees could exercise the lessee’s implied right to make reasonable use of the surface to conduct operations on their portion of the assigned property. Most disputes, however, do not concern the rights received by the assignee. Instead, the major issues concern the obligations acquired by the assignee and retained by the assignor.

A. Liability to Lessor

When the assignment covers all of the lessee’s interest, the assignee becomes responsible to the lessor for performance of lease obligations. However, the lessee remains obligated to the lessor for compliance with lease covenants; unless the lease contains a clause relieving the lessee from further liability. The assignee’s liability extends from the time the assigned interest is received until it is disposed of through further assignment. Liability is often adjusted between the parties through express provisions in the lease and assignment documents. For example, in an assignment by A to B, A might insist upon the following clause:
B assumes, and agrees to comply with, from and after the date of this assignment, the express and implied covenants created by the oil and gas lease. From and after the date of this assignment, B agrees to indemnify A against any liability, claim, demand, damage, or cost, including litigation costs and attorney fees, associated with the oil and gas lease and the interest assigned to B.

B should insist upon a reciprocal indemnity from A; for example: "A agrees to hold harmless and indemnify B against any claims or liabilities, arising prior to the date of this Assignment, for noncompliance with the express and implied covenants created by the oil and gas lease." Liability for all matters under the lease and prior assignments should be specifically allocated between the parties.

The assignor may want to be relieved of all future liability to the lessor. To obtain a release of future liability, the lessee may seek a novation of the lease contract and have the assignee substituted for the lessee, at which time the lessee’s liability will terminate. A novation requires the consent of the lessor who may be reluctant to give up the security provided by the lessee assignor’s continued liability. Most form oil and gas leases expressly terminate the lessee’s liability for acts
occurring on the lease after the assignment. For example:

In the event of assignment hereof in whole or in part, liability for breach of any obligation issued hereunder shall rest exclusively upon the owner of this Lease, or portion thereof, who commits such breach.144/

Another form of the clause, which allocates the resulting liability in more detail, provides:

If lessee assigns all or part of this lease, lessee shall be discharged, as to the assigned portion of the lease, from further liability, whether created by express or implied covenant, relating to lease obligations and acts or omissions occurring from and after the effective date of the assignment. Lessee shall remain liable to lessor for any breach of lease obligations, or any other actionable act or omission, occurring during, and to the extent of, lessee’s ownership of the lease. In the event lessee’s assignment fails to bind its assignee to perform lessee’s obligations under this lease, lessee’s liability to lessor will continue.
If the lessee wants to shift liability for past and present liabilities under the lease, the typical form of assignment clause must be broadened. Lessors, if aware of the impact of such a clause, would object since it could permit the lessee to escape liability for existing breaches of the lease by merely assigning it to a third party.

B. Impact of Assignment on Lease Obligations

In addition to defining each party’s liability to the lessor, the parties to an assignment are also concerned with how the assignment will affect underlying obligations created by the lease. These problems are most often encountered with the partial assignment. For example, if A, the mineral lessee of Section 30, assigns its leasehold interest in the East 1/2 to B, to what extent will the lessor be required, or entitled, to treat the lease as a single 640-acre lease? This is the "divisibility problem."145/

The oil and gas lease creates either "divisible" or "indivisible" rights.146/ The case of Cowman v. Phillips Petroleum Co.147/ demonstrates the basic divisibility problem. In Cowman the lessor granted an oil and gas lease to Harwood covering 400 acres. Harwood subsequently assigned 80 acres to
Phillips Petroleum Company. Harwood obtained production on his retained portion of the leasehold, extending the lease into its secondary term. No production had been obtained on the 80 acres assigned to Phillips. The lessor asserted the portion of the lease assigned to Phillips had expired for lack of production. The duration of the lease was for "five years, and as long thereafter as the lessee produces oil and gas or either of them from said land . . . ."147/ The lease expressly authorized Harwood to assign all or part of his interest in the lease.148/ Therefore, Phillips' 80-acre leasehold interest was extended by production from the Harwood tract. The court finds the requirement of production "from said land" referred to production from anywhere on the original 400-acre tract covered by the lease.149/ The court summarizes the basic rule quoting Mills-Willingham, Law of Oil and Gas:

[W]here the lease covers several tracts of land, although they may have passed into the ownership of different parties since the execution of the lease, a producing well drilled upon any of the tracts, during the term, will extend the fixed term as to the other tracts. And this is true although the lease upon the different tracts has come to be owned by different parties and there is no privity
of interest between the lessee, who drilled the producing well, and the owners of the lease upon the other tracts.150/

Leases often expressly address whether covenants are divisible. For example, in Wilson v. Texas Company151/ a quarter section of land was leased to Wakefield on 10 October 1935. In March 1936 Wakefield assigned Texas Co. the lease to the extent it covered the South Half of the quarter section. In April 1936 Wakefield drilled a dry hole on his retained portion of the lease. The court found that Wakefield’s drilling of the dry hole would relieve him from paying delay rentals on the lease, which were due 10 October 1936. More problematic was whether it would relieve Texas Co. from the need to pay delay rental on its portion of the lease. Texas Co. had not paid any delay rentals for this period of the lease. The lessor asserted the lease terminated as to the South Half of the quarter section assigned to Texas Co.

First, the court examines the "dry hole clause" of the lease and determines it expresses the intent that the clause be indivisible. A dry hole drilled on any portion of the leased land would entitle the owners to the benefits of the clause.152/ The lessor argued the assignment provisions of the lease made it divisible; when the Texas Co. assignment
was made, two segregated leases were created for delay rental purposes and operation of the dry hole clause. Rejecting this argument, the court notes the assignment clause permits either party to assign their interest in whole or in part and that the lease covenants extend to each party's assigns. The court holds the lease covenants "were extended (not enlarged or decreased) to the assigns of the parties." 153/

In Wilson the lease contained a common provision making the lease divisible for payment of delay rental. 154/ The delay rental clause is made divisible to protect the partial assignee, and the assignor, from improper administration of the delay rental obligation. For example, suppose a well had not been drilled by Wakefield in the Wilson case. On 10 October 1936 a delay rental payment of one dollar per acre, $160, would have been due. Wakefield, owning only the retained North Half of the quarter section, timely pays $80 representing rent on his retained 80 acres. Absent a special provision in the lease, if Texas Co. fails to pay $80 on or before 10 October 1936, the lessor can assert the entire lease (160 acres) terminated. The amount due to keep the lease alive was $160, not $80. 155/ The lessor would argue the option to pay delay rental was indivisible.

Lessees, anticipating the need for partial assignment,
usually provide in the lease how payment of delay rentals will be handled following a partial assignment. The express terms of the lease make the delay rental option "divisible" for certain purposes. In Wilson v. Texas Company the assignment clause contained the following provision:

[I]n the event this lease shall be assigned as to part or as to parts of the above described lands and the assignee or assignees of such part or parts shall fail or make default in the payments of the proportionate part of the rents due from him or them, such default shall not operate to defeat or affect this lease insofar as it covers a part or parts of said lands upon which the said lessee or any assignee thereof shall make due payment of said rentals.

When the partial assignment is of an undivided interest, or to a specified formation or depth in the leased land, such a clause will be of little assistance. Therefore, assignments of undivided interests, and limited depth assignments, must allocate the delay rental burden between the assignor and assignee. Assignments of undivided interests or subsurface divisions should specify which party is responsible for
payment of the full delay rental to the lessor.159/

One of the parties should be obligated to pay the full rental due and the other party required to reimburse the paying party for its proportionate share. The clause should also allocate liability in the event delay rentals are improperly handled, resulting in termination of the lease. A sample provision follows:

A [the partial assignor] will use its best efforts to properly pay all delay rentals required to extend the entire [oil and gas lease]. However, A will not be liable to B, except for gross negligence or willful misconduct, for failure to properly make delay rental payments. B will reimburse A for B’s proportionate share of delay rentals which will be equal to B’s proportionate assigned interest in the [oil and gas lease]. Upon payment of delay rentals, A will provide B with proof of payment and a bill for reimbursement. B will pay A’s billing within thirty (30) days after the date received by B.

The divisible or indivisible nature of express and implied covenants must be considered and accounted for in the lease
and assignment documents. Failure to do so may result in termination of the lease or additional lease obligations not intended by the parties. 160/

C. Allocating Leasehold Burdens

This section addresses the allocation of leasehold burdens among the parties to an assignment. For example, suppose a mineral owner leases to A, retaining a 1/8th royalty. A assigns a 1/16th of 8/8ths overriding royalty in the lease to X. A next assigns an undivided 1/2 interest in the lease to Y. How will X's overriding royalty, the "burden" on the lease, be allocated between A and Y? If A and Y address the matter in their assignment, the terms of their assignment will control. But if they fail to address the issue, how will the burden be allocated?

If X records the assignment creating the overriding royalty, all subsequent assignees will take subject to X's interest. Between A and Y, allocation of the burden may depend upon whether A's assignment to Y contained a warranty and whether X's interest was excepted from the warranty. If A gave a warranty, and failed to except X's interest from the warranty, Y could claim a breach of warranty against A.
However, this would not affect X’s rights. Suppose the assignment to X does not contain a warranty, or it contains a warranty and X’s interest is excepted from the warranty, how will the burden be allocated? Professor Hemingway offers the following possibilities:

Where the assignor merely assigns the interest in the lease, e.g. ‘an undivided one-half interest in the following described oil and gas lease,’ without mention of any outstanding interests, the assignor will bear the burden of such interests. . . . However, on the other hand, if the language is modified, e.g., ‘an undivided one-half interest in the following described oil and gas lease, subject, however, to any outstanding overriding royalty interests or production payments,’ the burden of all such interests will be borne by and subtracted from the interest of the assignee.

Normally, such a broad exception of outstanding interests will not be acceptable to the parties. In the usual case the parties are cognizant of the interests outstanding, and the assignment will expressly allocate the burden of such interest upon the appropriate party. Where the assignment is of an undivided interest in the lease, the customary agreement is
that all such burdens will be borne in proportion to the undivided interest assigned.161/

To avoid any dispute, the matter should be addressed in the assignment from A to Y. The assignment should indicate the extent to which A and Y's interests will be affected by existing lease burdens. For example, the assignment could provide:

Y agrees to bear its share of burdens created by any overriding royalty, production payment, or other third party rights to production, carved out of the lease and which were created, and properly recorded, prior to the date of this assignment [or a specified date to correspond with the assignee’s examination of title]. Y's share of any burden will be proportional to its working interest ownership in the oil and gas lease from which the burden was created.

When possible, a better approach would be to identify the burdens against the lease, and then specifically allocate them between A and Y. For example: "Y agrees to bear its proportionate share of the burden on production created by the X assignment."
If the assignment specifies the net revenue interest \( Y \) is to receive, the designated fraction or percentage will govern. For example, \( A \) could have assigned \( Y \) the undivided \( 1/2 \) interest in the lease and provided that \( Y \) will receive not less than \( 7/16 \)ths of gross production. This would indicate that \( Y \) would not have to carry any of the burden arising out of the prior assignment to \( X \). However, \( Y \)'s interest in production is still subject to the prior rights of the lessor and prior assignees. As between \( A \) and \( Y \), however, \( A \) would be responsible for payment of all burdens created by the lease and prior assignments.

D. Assignment/Sublease Problem

Throughout this article we have assumed all transfers of the lessee's interest were by "assignment" instead of by "sublease." An assignment is a transfer of the lessee's total interest in the leasehold; a sublease is a transfer of something less than the lessee's total interest. For example, if \( A \) owns an oil and gas lease covering Section 30, and transfers its leasehold rights in all or a separate portion of Section 30, \( A \) has made an "assignment" of its interest. However, if \( A \)'s lease is for a primary term of three years from 1 July 1985, and \( A \) transfers it to \( B \) for two
years from 1 July 1985, A has "subleased" the interest. Courts, in oil and gas cases, seldom address the assignment/sublease issue. However, the distinction can significantly impact the respective rights and obligations of the lessor, lessee, and their transferees.

When a transaction is classified as a sublease as opposed to an assignment, the relationships between the lessor, lessee, and transferees are altered. The "privity" between the parties is affected. The concept of "privity" requires the parties to be related in some manner before rights and obligations become binding upon their transferees. For example, before transferee C can become obligated to perform obligations under an oil and gas lease between A as lessor and B as lessee, there must be some sort of privity between A and C. Privity can be established two ways: by contractual agreement between A and C (privity of contract), or because of their ownership of interests--the lessor/lessee relationship between A and C (privity of estate). "Privity of contract" arises when the lease is entered into by the lessor and lessee. "Privity of estate" also exists because each hold current, mutually exclusive, interests in the leasehold.

The relationships between the parties change when B's transfer of rights is deemed a sublease as opposed to an
assignment. Even though B subleases some of its lease rights to C, B remains in privity of estate with A. There is no privity of contract or estate between A and C. A will therefore look to B for performance of all covenants under the lease. C's liability will be limited to that created by the terms of the sublease with B. If C fails to comply with the terms of the sublease, resulting in a breach of the lease between A and B, B will be solely responsible to A for the breach. Whether C is liable to B under the sublease will be determined by the terms of the sublease and not the terms of the A/B lease. Therefore, B must ensure its sublease with C is broad enough to require C's performance of B's obligations to A under the A/B lease. If the relationship between B and C is one of sublessor and sublessee, as opposed to assignor and assignee, issues concerning the divisibility of lease rights and obligations are avoided. As between A and B, all actions taken under the lease are treated as being those of B.

Once the distinction is recognized, the next problem is defining the dividing line between an assignment and a sublease. What rights can a lessee retain before the assignment becomes a sublease? Will a transferee's retention of an overriding royalty be sufficient to make the transfer a sublease as opposed to an assignment? Must the transferee
retain a true reversionary interest in the transferred interest?171/ These questions remain unanswered in most states.172/ When drafting documents transferring leasehold rights, the attorney must account for the possibility that retaining rights in the transferor may create a sublease as opposed to an assignment. The attorney cannot draft to resolve the uncertainty in classification, but the transfer document can be drafted to protect the lessee in the event their assignment is held to be a sublease. For example, the transfer document should impose upon the transferee the obligation to perform all express and implied lease covenants. The basic goal of the transferor is to draft a document which ensures it is able to take effective action against a transferee to compel performance of the lease. This is usually accomplished by having the sublease terminate when base lease violations are not promptly remedied. This permits the sublessor to regain possession of the leased premises so it can perform lease obligations.

VIII. PROBLEMS ASSOCIATED WITH NONOPERATING INTERESTS

The basic problem with nonoperating interests is that they terminate when the lease from which they were carved terminates.173/ The most common forms of nonoperating
interests, such as the overriding royalty, production payment, net profits interest, and carried interest, are all dependent upon the continued validity of the oil and gas lease.174/ If the lease is cancelled, terminated, or surrendered, the nonoperating interest will be destroyed.175/ The nonoperating interest owner wants to ensure the lease continues in effect, but they have no right to operate the lease to control the situation. Protection of the nonoperating interest requires careful drafting of the assignment creating the interest to provide a measure of control over the working interest owner. Nonoperating interest problems can be divided into two broad categories: accidental termination of the lease and intentional termination of the lease. A third area of dispute is the existence and scope of a working interest owner's implied obligations to a nonoperating interest owner. Although the law in each of these areas is somewhat unsettled, the drafting techniques to address each problem are fairly straightforward.

A. Accidental Termination

There are numerous ways a lessee can accidentally cause a lease to expire. Fumbling a delay rental or shut-in royalty payment can result in termination of the lease, and any
nonoperating interests carved from the lease. Failure to comply with other express and implied lease provisions can similarly result in termination, or cancellation. If the interest is destroyed through accident, the nonoperating interest has generally been denied recovery unless the assignment creating their interest provides otherwise. For example, in *Davis v. Cities Service Oil Company*,176/ Cities, the working interest owner, failed to file an affidavit of production covering its leased land. A subsequent developer, lacking effective notice of Cities’ lease, obtained a lease on the same land. The new lessee was deemed a bona fide purchaser; Cities’ leasehold rights in the land were extinguished—as were the rights of Davis and other nonoperating interest owners in the Cities lease. Davis, who owned an overriding royalty in Cities’ lease, asserted Cities had a duty to protect Davis’ interest and therefore should be liable to Davis for termination of his interest.177/

The court found Cities had no statutory or contractual duty to file the affidavit of production that would have protected Davis’ overriding royalty interest.178/ However, if the assignment had expressly created the duty, Cities would have been responsible for the loss. The court also notes that a different rule may apply if Cities was acting as a fiduciary for Davis and Cities had deliberately let the interest
terminate. However, the assignment lacked any language which would give rise to a fiduciary relationship between the parties.179/

Since it is impossible, by mere drafting, to prevent the working interest owner from making mistakes, the parties should provide in the assignment for the consequences of an accidental termination of the lease. The nonoperating interest owner should attempt to impose duties on the lessee to protect their interests and provide for liability in the event the duty is not performed.

B. Intentional Termination

There are two distinct categories of intentional termination. The first is when the lessee, for legitimate business reasons, surrenders a lease or permits it to expire. The second is when the lessee terminates the lease in order to eliminate nonoperating interests. As a general proposition, absent limiting language in the assignment, the lessee can terminate the lease, for legitimate business reasons, without consulting nonoperating interest owners.180/ However, to avoid dispute, the working interest owner should expressly provide in the assignment for the right to surrender or terminate the lease. A fair response by the nonoperating
interest owner would be to insist upon an opportunity to acquire the lease before the working interest owner lets it revert to the lessor.

For example, suppose a $5,000 delay rental payment will be required to keep the lease in effect. The working interest owner, for legitimate reasons, decides it will not pay the delay rental and will allow the lease to terminate. To ensure the nonoperating interest owners under the lease have an opportunity to protect their interests, it would seem proper to give them an opportunity to acquire the underlying oil and gas lease and pay the delay rental. Absent a special provision in the assignment creating the nonoperating interest, the working interest owner is under no obligation to offer the lease to other interest owners. Nonoperators often insist upon a reassignment clause to protect their interests. A typical reassignment clause provides:

Assignee will not surrender, abandon, or otherwise permit or cause the lease to terminate without offering to reassign the lease to assignor at least 30 days prior to any action or inaction by assignee which would terminate the lease.

However, many issues should be addressed by the
reassignment clause. First, what happens if the lessee fumbles the delay rental payment and the lease terminates? This would constitute a breach of the reassignment obligation since the lessee permitted or caused the lease to terminate by inaction. The lessee may insist upon amending the clause to provide protection against its negligence in administering the lease. In any event, the clause should indicate the measure of damages in the event the lease terminates without offering a reassignment. Arguably, the loss should be measured by the value of the unassigned lease instead of merely the value of the pre-existing nonoperating interest. Other problems concern what sort of title the lessee must provide when the interest is reassigned. Will it be free of encumbrances? Will the reassigned interest be subject to other burdens created after the assignment at issue? Perhaps the lessee is abandoning the lease because there are too many nonoperating interests to carry. A properly drawn reassignment clause could extinguish burdens created after the initial assignment and give the nonoperating interest owner an opportunity to engage in profitable operations.

Suppose the lessee would like to clear out nonoperating interests by terminating the existing lease and obtaining a new lease from the lessor. When done intentionally, with the specific goal of eliminating nonoperating interests, this is
called a "washout" transaction. However, the assignment may contain terms which either directly or indirectly limit the use of washout transactions. For example, in Probst v. Hughes the assignment reserving the overriding royalty stated: "This reservation shall . . . apply as to all modifications, renewals of such lease or extensions that the assignee, his successors or assigns may secure." In Probst the lessee obtained a new lease on the property while the prior lease was still in effect. The Oklahoma Supreme Court held the new lease was burdened by the overriding royalty stating: "the new lease constitutes a renewal or extension of the original lease within the meaning of the assignment . . . ." However, the court's opinion discusses at length the relationship of the overriding royalty owner and the lessee. The court finds that the lessee occupied a "position of trustee" toward the overriding royalty owner and was "duty bound to act in the utmost good faith" for the benefit of the overriding royalty owner.

In Howell v. Cooperative Refinery Ass'n, the assignment made the overriding royalty binding as to extensions and renewals of the lease, but the lease that was subsequently acquired did not fall into the definition of "extension or renewal." The new lease was obtained over a year after the prior lease had terminated. Nevertheless,
the Kansas Supreme Court held the new lease was burdened by the overriding royalty because the lessee had breached its fiduciary duty to the overriding royalty owner. The court found that a special relationship existed between the overriding royalty owner and the lessee. The overriding royalty owner was a geologist who helped to procure the new lease and had a form of "joint interest" in the enterprise. However, the court adopts, as a general rule governing the assignor/assignee relationship, the following statement:

While the transfer of a lease does not ordinarily create any confidential relationship between the parties, this is not, of course, always the case. The terms of the conveyance may be such as to impose upon the assignee or sublessee the duty of protecting the interests of the assignor or sublessor; and, whenever they are of such character, he must comply with the general rules that govern the conduct of persons occupying a trust status, and any effort on his part to procure from the lessor rights antagonistic to those of the assignor will be defeated. Thus, when an assignment expressly provides that any extension or renewal of the lease shall be subject to the
overriding royalty therein agreed upon, the courts will regard a new lease procured by the assignee as an extension or renewal of the old one and charge it with the royalty so reserved, even though it was not granted until production under the former lease had come to an end.196/

The Kansas and Oklahoma courts attach special significance to the extension or renewal clause as an indication that the parties have entered into a relationship of trust and confidence. Texas, on the other hand, requires something more than the mere presence of the clause to trigger fiduciary obligations.197/ For example, in Sunac Petroleum Corp. v. Parkes198/ the assignment creating the overriding royalty made it binding upon a "renewal or extension" of the lease.199/ The lessee formed a gas unit, drilled a well on acreage pooled with the leased land, and obtained an oil well. After the primary term expired, the lessee completed a producing oil well on the leased land. Subsequently, the lessor asserted the lease had terminated because the pooling clause was limited to a gas well. The lessee purchased a "new" lease from the lessor, and then ceased paying the overriding royalty owner once the new lease took effect.200/ The overriding royalty owner asserts the new lease was encompassed by the "renewal or extension" clause.
The court first concludes that the initial lease terminated due to the ineffective pooling.\textsuperscript{201} Therefore, at the time the new lease was obtained, no lease existed between the landowner and the lessee. The new lease was not an "extension" of the old lease: "An extension . . . means the prolongation or continuation of the term of the existing lease."\textsuperscript{202} Nor was the new lease a "renewal" of the old lease: "The lessors and lessees entered into the new lease over a year after the old lease had expired."\textsuperscript{203} The court therefore holds:

Since the new lease was executed under different circumstances, for a new consideration, upon different terms, and over a year after the expiration of the old lease, we hold that the new lease was not a renewal of the old lease.\textsuperscript{204}

The court proceeds to determine whether the assignment created a confidential relationship between the parties which could give rise to a constructive trust claim. Acknowledging the Kansas and Oklahoma cases on the subject, the court notes that the existence of a confidential relationship depends upon the facts of each case.\textsuperscript{205} In the Sunac case, although the assignment contained an extension or renewal clause, it also contained the following provision:
There shall be no obligation, express or implied, on the part of Assignee, its successors or assigns, to keep said lease in force by payment of rentals or drilling or development operations, and Assignee shall have the right to surrender all or any part of such leased acreage without the consent of Assignor.206/

The court finds this clause relieved the lessee of any duty to develop the land or continue the lease in force. 207/

To address the Texas approach to the extension and renewal clause, the clause could be expanded to include any subsequent lease covering the land obtained within a stated period of time after termination of the existing lease. For example:

The obligation to pay the overriding royalty required by this assignment will exist for the life of the oil and gas lease plus any extensions or renewals of the lease. For purposes of this Section, any leasehold interest acquired by assignee within _______ years following the termination, cancellation, or surrender of the oil and gas lease will be deemed an 'extension or
renewal.'

One potential problem with the extension and renewal clause is the rule against perpetuities.208/ If the vesting event is held to be the execution of an extension or renewal of a lease, it is quite possible this will occur beyond 21 years from the date the assignment containing the right takes effect. Similarly, the provision which takes effect a stated period following "termination, cancellation, or surrender" could likewise occur beyond 21 years from the assignment date. Although application of the rule against perpetuities probably serves no valid purpose in this situation, this has not prevented courts from applying the rule in other contexts.209/ Perhaps a better approach would be to use language which expressly imposes an obligation on the lessee to protect the interests of nonoperators. For example:

[Lessee] owes [overriding royalty owner] a fiduciary duty to deal with the leased property in a manner that will protect the overriding royalty owner's interests against any action or inaction by the lessee [or its successors and assigns] that could impair or terminate the overriding royalty owner's rights under this assignment.
The goal of such a provision is to establish the right to impose a constructive trust against any interest the lessee may obtain in the property which tends to defeat or diminish the nonoperator's interests. The lessee must be careful in agreeing to such a broad obligation because it could permeate the relationship with additional obligations, such as implied obligations to develop the property and protect against drainage.

C. Implied Covenants

If the assignment is silent regarding the lessee's obligation to develop the leased land, or protect it from drainage, the nonoperating interest owner will insist on the same sort of implied covenant protection the courts have granted lessors. The Texas Supreme Court, in Bolton v. Coats, has recognized an implied covenant by the lessee to protect an overriding royalty owner against drainage. The court, acknowledging that the situations of the lessor and nonoperating interest owner are analogous, states:

Unless the assignment provides to the contrary, the assignee of an oil and gas lease impliedly covenants to protect the premises against drainage when the assignor reserves an overriding royalty.
The extent to which the nonoperating interest owner will be equated to the lessor is not clear. For example, since assignments typically do not mention any sort of drilling obligation, will a covenant to test the property within a reasonable time be implied? Other courts have been unwilling to treat the nonoperating interest owner like a lessor and have refused to imply covenants to develop and protect against drainage.

The lessee will seek express language to negate any implied obligation to develop the property or protect nonoperating interests. The nonoperating interest owner will seek express covenants to protect their interests. Often the nonoperating interest owner will provide for the right to enforce the express and implied obligations created by the oil and gas lease. However, merely enforcing the lease covenants may not, in all cases, fully protect the nonoperating interest owner.
1. Although there is no such thing as a standard oil and gas lease form, all forms tend to contain the same basic types of clauses. The primary term of the habendum clause may vary, but all lease forms typically have some sort of habendum clause that provides for a specified primary term followed by a secondary term defined by production. The specific fraction of royalty may vary, but all lease forms typically compensate the mineral owner through a share of production. The creation of such standard relationships facilitates the marketability of leasehold interests. If the general lease format used by company A is similar to the format used by other companies, the marketability of A's leasehold interest will be enhanced. See Pierce, Rethinking the Oil and Gas Lease, 22 Tulsa L. J. 445, 450, 457 (1987).

The motivating force for assigning an interest in a lease is usually economic. The lessee may have acquired the lease in hopes of selling it for a profit. The lessee may be financing its development by selling interests in the lease to investors. The lessee may not have, or be able to raise, the money necessary to develop the lease. The lessee may not place as great a value on the lease as an assignee who may have more, or less, geological information regarding the leased land.

2. Assignment forms have not attained the degree of homogeneity that is encountered with lease forms. This greater diversity can be attributed to the greater sophistication of the parties who typically enter into assignments.


4. Each word in the document should be there for a reason. If the word, phrase, sentence, or paragraph does not serve some purpose in the document, it should be eliminated.

5. One of the foremost goals is to avoid future disputes by identifying areas of potential dispute, discussing them during negotiations, and clearly recording the resolution of such issues in the assignment.

6. For an exhaustive analysis of classification problems see 1 H. Williams and C. Meyers, Oil and Gas Law, §§ 201 - 216.8 (1988).


15. Id.

16. If the property interest is classified as real property, the spouse may have homestead or similar rights in the property.

17. If the oil and gas lease is classified as personal property, an assignment of the lease for a fair price implies a warranty of title in the assignor. Ratcliffe v. Paul, 114 Kan. 506, 220 P. 279 (1923).


19. U.C.C. § 2-105(1) (1977) provides, in part: "'Goods' means all things . . . which are movable at the time of identification to the contract for sale . . . . 'Goods' also includes . . . other identified things attached to realty (Section 2-107)." U.C.C. § 2-107(2) (1977) provides, in part: "A contract for the sale apart from the land of . . . things attached to realty and capable of severance without material harm thereto . . . is a contract for the sale of goods within this Article . . . ."

20. U.C.C. § 2-316 (1977) requires the use of explicit language to exclude or modify the implied warranty of merchantability; the language must be "conspicuous" in the document.

21. See generally 2 D. Pierce, Kansas Oil and Gas Handbook §§
17.25 and 17.26 (Kan. B. Ass’n 1989) (discussing gas purchase agreements and gas balancing agreements).

22. Contract law carefully distinguishes between the assignment of rights under a contract from the delegation of duties created by the contract. Professor Farnsworth explains the distinction:

An obligee’s transfer of a contract right is known as an assignment of the right. By an assignment, the obligee as assignor (B) transfers to an assignee (C) a right that the assignor (B) has against an obligor (A). An obligor’s empowering of another to perform his duty is known as a delegation of the performance of that duty. By a delegation, the obligor as party delegating (B) empowers a delegate (C) to perform a duty that the party delegating (B) owes to an obligee (A).

E. Farnsworth, Contracts 746 (1982).

Instead of employing a contract analysis for oil and gas lease assignment issues, courts treat the transaction more like a conveyance. Even in states which classify the oil and gas lease as a contract, courts tend to apply property law conveyancing concepts to the lease and lease assignments. For example, the assignee ordinarily does not execute the assignment. Instead, the parties rely upon delivery and acceptance of the assignment to bind the assignee -- similar to the analysis applied to deeds in conveyances of real property. E.g., Hansen v. Walker, 175 Kan. 121, 259 P.2d 242 (1953).

23. The assignment may impose drilling obligations on the assignee, or it may require the assignee to deliver a share of production to the assignor in the form of an overriding royalty, production payment, or net profits interest.

24. This is accomplished by properly recording the assignment to provide constructive notice of each party’s rights in the affected land.

25. These obligations are discussed in section VIII of this article. See infra text accompanying notes 173-75.

26. These matters are discussed in section VII of this article. See infra text accompanying notes 137-38.

27. The parties must take the situation as established by the oil and gas lease and prior assignments. See Terrell v. Munger Farm Co., 129 S.W.2d 407, 411 (Tex. Ct. App. 1939) ("The assignee did not get any right under the lease that the original lessee did not receive.").
28. This is particularly troublesome when the lessee is entering into operating agreements, gas balancing agreements, and gas sales contracts. Although these agreements can directly impact the lessor, the lessor is not a party to any of the agreements. See Exxon Corp. v. Middleton, 613 S.W.2d 240 (Tex. 1981) (lessor not bound by gas prices established by gas sales contract).

29. Lessees, anticipating subsequent assignments, generally try to address these matters in the lease. See infra text accompanying notes 43-44.

30. Typically this is accomplished by having B agree to indemnify A against any loss A may suffer due to B’s nonperformance. However, since an indemnity is only as good as the indemnitor’s ability to indemnify, A may want additional protection -- such as a reversion of assigned rights in the event of B’s nonperformance.

31. For example, the assigned property may be subject to a gas purchaser’s right to take makeup gas that it has already paid the assignor for prior to the assignment. Perhaps there are accrued rights, relating to the assigned interest, to produce and market a disproportionate share of gas under a gas balancing agreement.

32. See, e.g., Tex. Prop. Code Ann. § 13.001(a) (Vernon Supp. 1990) which provides, in part: "A conveyance of real property or an interest in real property . . . is void as to a creditor or to a subsequent purchaser for valuable consideration without notice unless the instrument has been acknowledged, sworn to, or proved and filed for record as required by law."

33. If the secured party wants to establish a secured position in all rights associated with the leasehold, they will need to perfect a security interest in the lease, production, production proceeds, well equipment, fixtures, and any general intangible property associated with the lease. In many states this may require, in addition to making a mortgage filing, local and central UCC Article 9 filings. See generally Ingram v. Ingram, 214 Kan. 415, 521 P.2d 254 (1974).

34. In Texas this concept is codified at Tex. Prop. Code Ann. § 13.001(b) (Vernon Supp. 1990) ("The unrecorded instrument is binding on a party to the instrument, on the party’s heirs, and on a subsequent purchaser who does not pay a valuable consideration or who has notice of the instrument.").

35. Tex. Prop. Code Ann. § 13.001(a) (Vernon Supp. 1990) provides, in part: "A conveyance of real property or an interest in real property . . . is void as to a creditor or to a subsequent purchaser for valuable consideration without notice unless the instrument has been acknowledged, sworn to, or proved and filed for
record as required by law."

36. If A gives B a recordable assignment, B may make a number of subsequent assignments that would complicate a reassignment in the event B fails to "earn" the assigned acreage.


40. See, e.g., the Texas statute infra note 35.


(a) An instrument concerning real or personal property may be recorded if it has been acknowledged, sworn to with a proper jurat, or proved according to law.

(b) An instrument conveying real property may not be recorded unless it is signed and acknowledged or sworn to by the grantor in the presence of two or more credible subscribing witnesses or acknowledged or sworn to before and certified by an officer authorized to take acknowledgements or oaths, as applicable.

42. E.g., Watts v. England, 168 Ark. 213, 269 S.W. 585 (1925). Classification of the interest as either a conveyance of real property, or a transfer of contract rights, could impact the analysis used by courts to determine whether rights can be assigned and duties delegated. However, the courts seem to treat the transaction more like a conveyance when considering whether the leasehold interest can be transferred to others. E.g., Shields v. Moffitt, 683 P.2d 530 (Okla. 1984). Even in Kansas, where the oil and gas lease is personal property and frequently referred to as a "contract," such rights and duties are freely assignable. Matthews v. Ramsey-Loyd Oil Co., 121 Kan. 75, 81-82, 245 P. 1064, 1067 (1926).

Even if a contract analysis is employed, the result may be the same. For example, in Heffington v. Hellums, 212 S.W.2d 245 (Tex. Ct. App. 1948) writ ref’d n.r.e., the court held that duties could be freely delegated under a contract to operate a well. The court found that the operation of a well does not require the degree of personal skill, confidence, character, or trust that would preclude
delegation. **Heffington**, 212 S.W.2d at 248.


45. *E.g.*, **Moherman v. Anthony**, 103 Kan. 500, 175 P. 676 (1918) ("This lease is transferable only by consent of first party [lessor]. If sold, first party to receive one-half of the consideration lease is sold for.").


48. **Knight v. Chicago Corporation**, 144 Tex. 98, 188 S.W.2d 564 (1945).


50. This was the defect which caused the Texas and Oklahoma courts to find the restriction void as an unreasonable restraint against alienation. **Outlaw v. Bowen**, 285 S.W.2d 280 (Tex. Ct. App. 1955); **Shields v. Moffitt**, 683 P.2d 530 (Okla. 1984).


52. *E.g.*, **Knight v. Chicago Corporation**, 144 Tex. 98, 188 S.W.2d 564 (1945).


54. See, *e.g.*, **Warmack v. Merchants Nat’l Bank**, 612 S.W.2d 733 (Ark. 1981); Restatement (Second) of Property (Landlord and Tenant) § 15.2(2) (1977), which states:

(2) A restraint on alienation without the consent of the landlord of the tenant’s interest in the leased property is valid, but the landlord’s consent to an alienation by the tenant cannot be withheld unreasonably, unless a freely negotiated provision in the lease gives the landlord an absolute right to withhold consent.

55. For example, in Trafalgar House Oil & Gas v. De Hinojosa, 773 S.W.2d 797, 799 (Tex. Ct. App. 1989), the lease provides: "[N]o assignment nor reassignment shall operate to relieve LESSEE or its assignees from any liability or responsibility hereunder." If this approach is followed, other clauses in the lease must be carefully reviewed and, if necessary, modified. For example, many leases have a clause similar to the following:

In the event of assignment hereof in whole or in part, liability for breach of any obligation issued hereunder shall rest exclusively upon the owner of this Lease, or portion thereof, who commits such breach.


56. The significance of the assignment/sublease distinction is discussed in section VII of this article. See infra text accompanying notes 162-72.

57. Generally, if the assignment covers all of the lessee's interest, the assignee will become responsible to the lessor for performance of lease obligations. However, unless the lease contains a clause relieving the lessee/assignor from further liability, the lessee will remain obligated to the lessor for performance of lease obligations. The assignee's liability will extend from the time the assigned interest is received until it is disposed of through assignment to others. Hale v. Oil Co., 113 Kan. 176, 180, 213 P. 824, 826 (1923). However, liability can be, and frequently is, adjusted between the parties by express provisions in the lease.

58. To be effective, the clause must make the lessee responsible for assignments it makes and subsequent assignments made by the lessee's assignees. Otherwise, the lessee may be able to avoid liability by assigning the interest to an intermediary that in turn assigns to others.

59. Although a restriction on assignment may be an unlawful restraint against alienation, the cases do not suggest a burden such as continuing lessee liability would be open to attack. Instead, the cases seem to suggest the need for a burden to make the restraint lawful. When the lessor is given the right to withhold consent, the cases focus on the lack of reversion, forfeiture, or other penalty for assignment without the requisite consent. E.g., Shields v. Moffitt, 683 P.2d 530 (Okla. 1984) (restriction on assignment of oil and gas lease); Outlaw v. Bowen, 285 S.W.2d 280 (Tex. Ct. App. 1955) (restriction on transfer of
mineral interest).

60. For example, Kan. Stat. Ann. § 55-179(b) (Supp. 1989) imposes liability on a chain of potential defendants when a well is improperly plugged or abandoned. Persons who may be legally responsible for improper plugging or abandonment of a well include, "but is not limited to:" the original operator, the current operator, or the last operator.

61. Having control over the leased premises arguably imposes primary liability for taking care of any pollution problems existing on the lease. Only the current operator has the right to enter and conduct operations on the lease.

62. A similar concept is applied for the regulation of hazardous wastes under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) 42 U.S.C.A. §§ 9601 to 9675 (Supp. 1989). By imposing potential liability on any party acquiring the property where a plugging problem exists, it will force them to act diligently to discover and resolve the problem prior to purchasing the property. However, subsection (e) of Kan. Stat. Ann. 55-179 (Supp. 1989) provides:

For the purpose of this section, the person legally responsible for the proper care and control of an abandoned well shall not include the landowner or surface owner unless the landowner or surface owner has operated or produced the well, has deliberately altered or tampered with such well thereby causing the pollution or has assumed by written contract such responsibility.

63. Absent a special provision in the lease, or an assumption of liability in the assignment, the assignee is liable only for matters occurring during the assignee's ownership of the lease. E.g., Ardizzone v. Archer, 71 Okla. 289, 160 P. 446 (1916).

64. Although such a provision will surely discourage assignment, apparently the courts will not view it as an unlawful restraint against alienation. See Shields v. Moffitt, 683 P.2d 530 (Okla. 1984); Outlaw v. Bowen, 285 S.W.2d 280 (Tex. Ct. App. 1955) (restriction on transfer of mineral interest).

65. See, e.g., Knight v. Chicago Corporation, 144 Tex. 98, 188 S.W.2d 564 (1945).

66. See discussion infra note 54.

67. This is a product of the strict interpretation rule.

68. See infra text accompanying notes 139-42. See generally R. Sullivan, Handbook of Oil and Gas Law § 129 (1955).
69. 103 Kan. 500, 175 P. 676 (1918).

70. The lessor in Trafalgar House Oil & Gas v. De Hinojosa, 773 S.W.2d 797 (Tex. Ct. App. 1989), had a creative approach. The lease provides, in part:

The right of either party hereunder may be assigned in whole or in part . . . . In the event of assignment, LESSEE, its successors and assigns, shall give notice of the fact of such assignment and the name and address of the assignee within thirty (30) days after such assignment; and, LESSOR shall likewise be notified upon each subsequent assignment. Upon each failure of the LESSEE, its successors and assigns to comply with the foregoing ‘notice of assignment’, said LESSEE, his successors and assigns shall jointly and severally forfeit and pay unto the Lessor the sum of ONE THOUSAND AND NO/100 ($1,000.00) DOLLARS as liquidated damages.

Trafalgar, 773 S.W.2d at 799. Apparently the lease had been assigned twenty times without anyone giving the lessor the required notice. The lessor brought suit seeking $20,000 in liquidated damages. The court upholds a $20,600.00 judgment in the lessor’s favor finding the notice of assignment provision was an enforceable liquidated damages agreement.


73. See Stephens County v. Mid-Kansas Oil and Gas Co., 113 Tex. 160, 254 S.W. 290 (1923) (oil and gas lease creates a fee simple determinable).

This article does not address the myriad formalities imposed on the transfer of leases covering Indian, federal, state, or local government lands.


A conveyance of an estate of inheritance, a freehold, or an estate for more than one year, in land and tenements, must be in writing and must be subscribed and delivered by the conveyor or by the conveyor’s agent authorized in writing.


77. Id.


80. It is the author's position that proper drafting requires identification of the minimum wording necessary to create an effective instrument. "More" is never "better" unless there is a legitimate reason for the additional language. Any language which clearly indicates the grantor's intent to convey the property to the grantee is sufficient. See Harlan v. Vetter, 732 S.W.2d 390 (Tex. Ct. App. 1987).

81. If tangible personal property is being conveyed as part of the transaction, the word "conveys" would seem appropriate since the word "assigns" is generally associated with the transfer of intangible property.

82. If the lessee intends to retain an interest in the leasehold, the assignment must clearly identify the exception from the grant. The same problem is encountered with the conveyance of a mineral interest, or land in which the minerals and surface have not been severed. See, e.g., Stratmann v. Stratmann, 6 Kan. App.2d 403, 408, 628 P.2d 1080, 1085 (1981) (royalty interest deemed conveyed).


84. In Briscoe v. Reschke, 170 Kan. 367, 226 P.2d 255 (1951), the court states the general rule on consideration for a conveyance as follows:

As between the parties, their heirs or privies, a deed is good without consideration in the absence of a wrongful act on the part of the grantees such as fraud or undue influence.

Briscoe, 170 Kan. at 376, 226 P.2d at 262.

85. E.g., Schloss v. Unsell, 114 Kan. 69, 70-71, 216 P. 1091, 1092 (1923).

86. Edwards v. Meyers, 127 Kan. 221, 223-24, 273 P. 468, 470 (1929) ("valuable consideration" required as opposed to merely "nominal consideration").


89. The actual consideration given for the transfer need not be disclosed in the assignment.

90. In some states a waiver of homestead rights may require "adequate" consideration. See, e.g., Schloss v. Unsell, 114 Kan. 69, 70-71, 216 P. 1091, 1092 (1923).

91. However, use of the phrase "valuable consideration," for a recitation, will be sufficient. If a dispute arises concerning whether the consideration given was in fact "adequate" or "valuable," the issue will be resolved by looking at the consideration paid, not what is recited in the conveyance.


93. In re Estate of Crawford, 176 Kan. 537, 271 P.2d 240, 244 (1954) (conveyance of "mineral rights and oil royalties or properties heretofore conveyed by me and lots in the town of Stafford").


99. Id.

100. See generally 6A R. Powell, Powell on Real Property §898(2) (b) (1984).

101. E.g., McAndrew v. Sowell, 100 Kan. 47, 163 P. 653 (1917) (grantee attempted to avoid liability for encumbrance on conveyed land asserting lack of acceptance).


recording.


(a) An instrument executed after December 31, 1981, conveying an interest in real property may not be recorded unless:

(1) a mailing address of each grantee appears in the instrument or in a separate writing signed by the grantor or grantee and attached to the instrument; or

(2) a penalty filing fee equal to the greater of $25 or twice the statutory recording fee for the instrument is paid.


111. See, e.g., Moser v. United States Steel Corp., 676 S.W.2d 99 (Tex. 1984).


114. See Terrell, supra note 113, at 17-10.

115. Id.

116. See, e.g., Carter Oil Co. v. McCasland, 190 F.2d 887 (10th Cir. 1951); Carter Oil Co. v. State, 205 Okla. 541, 240 P.2d 787 (1951); Palmer Oil Corp. v. Phillips Petroleum Co., 204 Okla.


118. Lowe, supra note 113, at 806, 825.

119. See Terrell, supra note 113, at § 17.03.

120. Id.


133. Id. at 924. See also Julian v. Oil Co., 83 Kan. 127, 109 P. 996 (1910), where the prior assignment stated that if the assignee encumbered the assigned interest it would revert to the assignor. A subsequent assignee encumbered the assigned interest
causing it to revert to the original assignor. The rights of the reversionary assignors were upheld against the claims of creditors who had contracted with the assignee for payment of their loan out of production allocated to the assigned interest.


(v) ‘Overriding royalty’ means a share of production, free of the costs of production, carved out of the lessee’s interest under an oil and gas lease;

(vi) ‘Costs of production’ means all costs incurred for exploration, development, primary or enhanced recovery and abandonment operations including, but not limited to lease acquisition, drilling and completion, pumping or lifting, recycling, gathering, compressing, pressurizing, heater treating, dehydrating, separating, storing or transporting the oil to the storage tanks or the gas into the market pipeline. ‘Costs of production’ does not include the reasonable and actual direct costs associated with transporting the oil from the storage tanks to market or the gas from the point of entry into the market pipeline or the processing of gas in a processing plant;

(vii) ‘Royalty’ means the mineral owner’s share of production, free of the costs of production . . .

This is followed by Wyo. Stat. § 30-5-305(a) (Supp. 1989) (emphasis added) which provides, in part:

(a) Unless otherwise expressly provided by specific language in an executed written agreement, ‘royalty’, ‘overriding royalty’. . . shall be interpreted as defined in W.S. 30-5-304. A division order may not alter or amend the terms of an oil and gas lease or other contractual agreement.

138. Id. at 425, 646 P.2d at 480. See Delhi Gas

order may not alter or amend the terms of an oil and gas lease or other contractual agreement.


138. Id. at 425, 646 P.2d at 480. See Delhi Gas Pipeline Corp. v. Dixon, 737 S.W.2d 96 (Tex. Ct. App. 1987) writ denied n.r.e. (Lessee could assign to pipeline the right to use surface of a tract of land to transport gas from unit well in which the tract participated).

139. Professor Sullivan observes in his treatise:

The liability of an assignee of the lessee is predicated upon privity of estate unless he expressly assumes the obligations of the lease in the instrument of assignment.


141. E.g., Ardizzone v. Archer, 71 Okla. 289, 160 P. 446 (1916).

142. See generally E. Farnsworth, Contracts 284 (1982) ("The term novation is used to describe a substituted contract that discharges a duty by adding a party who was neither the obligor nor the obligee of that duty.").

143. See E. Farnsworth, Contracts 806-07 (1982).


146. Id.


148. Id. at 763, 51 P.2d at 989.


152. Id. at 454, 76 P.2d at 782.


154. Id. at 451, 76 P.2d at 781.

155. See Cosden Oil Co. v. Scarborough, 55 F.2d 634 (5th Cir. 1932); Gulf Oil Corp. v. Prevost, 538 S.W.2d 876 (Tex. Ct. App. 1976).

156. A common Texas lease form provides:

   In the event of an assignment of this Lease as to a segregated portion of said land, the rental payable hereunder shall be apportioned as between the several leasehold owners ratably according to the surface area of each, and default in rental payment by one shall not affect the rights of other leasehold owners.


158. Id. at 451, 76 P.2d at 781.

159. For example, in Huggs, Inc. v. LPC Energy, Inc., 889 F.2d 649 (5th Cir. 1989), the court enforces a provision in the development contract and joint operating agreement which provide the operator will not be liable for losses relating to "mistake or oversight if any delay rental or shut-in gas royalty payment is not paid or is erroneously paid." Huggs, 889 F.2d at _____. See generally Terrell, supra note 113, at § 17.04[2][b].

160. See generally Merrill, The Partial Assignee -- Done In Oil, 20 Tex. L. Rev. 298 (1942).


163. Robinson v. Eagle-Picher Lead Co., 132 Kan. 860, 862, 297 P. 697, 698 (1931) (transfer of rights under mining lease for a shorter duration than the original term constituted a sublease; transfer of all rights in the lease constituted an assignment).

164. Id.


166. Privity concepts are illustrated by the following situations:

A (lessor) leases Section 30 to B (lessee): privity of contract and estate exist between A and B.

B assigns all its rights in the lease to the North Half of Section 30 to transferee C: A and B remain in privity of contract but are no longer in privity of estate as to the North Half of Section 30; A and C are in privity of estate as to the North Half of Section 30. If C fails to comply with the lease terms, A may sue B (because there remains privity of contract) and C (because there is privity of estate).

B assigns all its rights in the lease to transferee C, C subsequently assigns all his rights to transferee D: If D fails to comply with the lease terms, A may sue B (privity of contract) and D (privity of estate). However, A cannot sue C for violations of the lease which occur before or after C’s term of ownership because there will be no privity of estate or contract between A and C. Privity of estate between A and C terminates once C assigns its interest to D.

B assigns all its rights in the lease to transferee C who, in the assignment document, expressly agrees to perform all lease covenants due A under the lease: If C fails to comply with the lease terms, A may sue B (privity of contract) and C (privity of estate and privity of contract since A is a third party beneficiary of C’s promise to B to perform the lease covenants).

The lease between A and B expressly provides that if B assigns its rights B will be relieved from future liability. B assigns all rights in the lease to transferee C: If C fails to perform all lease covenants due A, A will not be able to sue B but will be permitted to sue C since there is privity of estate.
between A and C.

See generally 1 D. Pierce, Kansas Oil and Gas Handbook § 7.12 (1986).


170. Most commentators suggest the assignment/sublease distinction should not be applied to the oil and gas lease. Merrill, The Partial Assignee -- Done In Oil, 29 Tex. L. Rev. 298, 322 (1942) ("Here again we have an analogy, drawn from the law of landlord and tenant, utterly inappropriate to the law of oil and gas.").

The North Dakota Supreme Court, in Holman v. State, 438 N.W.2d 534 (N.D. 1989), rejected the assignment/sublease distinction holding that the mere retention of an overriding royalty does not create a sublease. However, in Willis v. International Oil & Gas Corp., 541 So.2d 332 (La. App. 1989), the Louisiana Court of Appeals held that retention of an overriding royalty created a sublease as opposed to an assignment.

171. In Sunburst Oil and Ref. Co. v. Callender, 84 Mont. 178, 274 P. 834 (1929), reservation of an overriding royalty was sufficient to make the transaction a sublease. See also Holman v. State, 438 N.W.2d 534 (N.D. 1989) (retention of overriding royalty did not create a sublease) and Willis v. International Oil & Gas Corp., 541 So.2d 332 (La. Ct. App. 1989) (retention of overriding royalty created a sublease).


In jurisdictions, such as Texas, which view the oil and gas lease as a fee simple determinable, a court is unlikely to apply the distinction between assignments and [sub]leases to lease transfers, for the underlying document is not a 'lease' in the traditional common law sense.

See generally Brown, Assignments Of Interests In Oil And Gas Leases, Farm-out Agreements, Bottom Hole Letters, Reservations Of Overrides And Oil Payments, 5th Inst. on Oil and Gas L. & Tax’n 25 (1954); Logan, Nonproducer Speculation in Oil and

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Merrill, The Partial Assignee - Done in Oil, 29 Tex. L. Rev. 298 (1942).


175. Id.

176. 338 F.2d 70 (10th Cir. 1964).

177. Id. at 74.

178. Id. However, in Huggs, Inc. v. LPC Energy, Inc., 889 F.2d 649 (5th Cir. 1989), the court held the assignor/operator liable for the loss of a lease for failing to rework a well. The agreement required LPC to reassign the lease to Huggs if LPC decided not to continue it in force. The court holds LPC breached this obligation when it permitted the lease to terminate without reassigning to Huggs. Holders of overriding royalty interests who were not parties to the operating agreement could recover for their loss through a tort action against LPC for gross negligence.

179. Id. at 75.


183. See McLaughlin v. Ball, 431 S.W.2d 305 (Tex. 1968) (nonoperating interest owner entitled to damages equal to the value of the unassigned leasehold interest). See also 2 H. Williams & C. Meyers, Oil and Gas Law § 428.2 (1988).

184. The clause should also allocate rights in the equipment necessary to continue operation of the well. This is usually done by requiring the party taking over operations to pay the salvage value of the leasehold equipment. The parties will also need to allocate plugging obligations.

185. Sunac Petroleum Corp. v. Parkes, 416 S.W.2d 798, 304
(Tex. 1967).

186. 143 Okla. 11, 286 P. 875 (1930).


188. Probst, 286 P. at 877.

189. Id. at 879.

190. The court quotes the following from Trice v. Comstock, 121 F. 620 (8th Cir. 1903):

'Whenever one person is placed in such a relation to another . . . that he becomes interested for him, or interested with him, in any subject of property or business, he is in such a fiduciary relation with him that he is prohibited from acquiring rights in that subject antagonistic to the persons with whose interests he has become associated.'

Probst, 286 P. at 877.

191. Probst, 286 P. at 878.


194. Id.

195. Id.


197. Apparently in Texas the courts will inquire into the actual relationship between the parties. See Sunac Petroleum Corp. v. Parkes, 416 S.W.2d 798, 805 (Tex. 1967).

198. 416 S.W.2d 798 (Tex. 1967).

199. Id. at 799.

200. Id. at 800.

201. Id. at 802.

202. Id.

203. Id.

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204. Id. at 803.
205. Id. at 805.
206. Id. at 804.
207. Id.


209. For example, in Kansas a nonparticipating royalty interest is void as a violation of the rule against perpetuities. See generally 1 D. Pierce, Kansas Oil and Gas Handbook § 4.13 (1986).

210. 533 S.W.2d 914 (Tex. 1976).
211. Id. at 916.

212. Professor Sullivan has noted: "The same reasons for implying covenants of drilling, development, protection, and marketing in favor of an oil and gas lessee apply to the owner of an overriding royalty interest." R. Sullivan, Handbook of Oil and Gas Law 241 (1955).

213. See 2 H. Williams & C. Meyers, Oil and Gas Law 355-56 (1988) ("Certainly the weight of authority is to the effect that a covenant to drill a well is not to be implied from the severance of some nonoperating share of the working interest, e.g., an overriding royalty or oil payment.").
