Rights of First Refusal and Package Oil and Gas Transactions

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RIGHTS OF FIRST REFUSAL AND PACKAGE OIL AND GAS TRANSACTIONS

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I. INTRODUCTION

Corporate transactions between oil companies or investors such as divestitures, acquisitions, mergers, consolidations, or reorganizations are almost as common an event today as spudding a new well. These transactions can range from a simple, low-dollar single-asset handshake deal, to an international transaction involving millions (or more) dollars of consideration, multiple regulatory-agency reviews or approvals, reams of paper, and terabytes of digital storage. When the transaction involves multiple assets, and a third party has a right of first refusal on one or more - but not all - of the assets, the transaction becomes more complicated. Unless the preferential right is for a predetermined price, most preferential purchase agreements give the rightholder the option of purchasing the burdened property for the same terms and conditions offered by a third party. If so, an agreement that was negotiated on the basis of a broader, multifaceted transaction must entertain the legal fiction: what is the seller offering and the buyer agreeing to accept for the burdened property? This is described as a legal fiction because neither party may have given much thought to the value of the burdened property while negotiating the package transaction; and even if they did, they could easily have a meeting of the minds on the value of the entire package but have very different opinions on the value of that asset. Beyond
the complication of valuing the burden asset(s), the parties must also determine what notice to
provide the rightholder and it must decide both if the proffered purchase opportunity is desirable
and if the proffered terms and conditions truly reflect the consideration being exchanged for the
burdened property.

This paper will briefly address preferential purchase agreements in general and will then
consider the operation of a preferential purchase agreement in the context of a larger package
transaction with particular attention being given to the unique issues and problems they can
cause in oil and gas transactions. Finally, the paper will cover the issues likely to be raised in
litigation over preferential purchase provisions triggered by a package transaction. The paper
will focus primarily on Texas law because of the large number of oil and gas transactions that
occur in Texas, but the law of other jurisdictions will be cited as an example of the different
approaches being taken nationwide.

II. RIGHTS OF FIRST REFUSAL IN GENERAL. 1

A right of first refusal is a preemptive right 2 and, essentially, a dormant option. 3 In the
most general of terms, a right of first refusal provides the rightholder with the right to purchase
the burdened property if the owner elects to sell -- either at a predetermined price or on the same

1 For an excellent discussion of preferential purchase provisions see Robert K. Wise, Andrew J. Szygenda, and
3 A.G.E., Inc. v. Buford, 105 S.W.3d 667, 673 (Tex. App.—Austin 2003, pet. denied). It is a dormant option
because, unlike an optionee, the rightholder cannot compel the sale of the encumbered property. See Harry M.
Reasoner, Preferential Purchase Rights in Oil and Gas Instruments, 46 TEX. L. REV. 57, 57 (1967).
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terms and conditions offered by a third party.\(^4\) The property owner is obligated to provide notice of its intent to sell and to offer the property to the rightholder.\(^5\) The method of making the offer, the substance of the offer, and the method of accepting the offer are a function of the preferential purchase provision’s language.\(^6\) So long as the property is being sold, the preferential right is triggered regardless of the form of the consideration being exchanged.\(^7\) When the owner provides notice to the rightholder, the right becomes an irrevocable option.\(^8\) The rightholder must then accept or reject that option within the time allowed in the notice.\(^9\)

There are important limits to a preferential purchase right. For example, it does not give the rightholder a right to negotiate with the seller or the power to compel the owner to sell the property.\(^10\) When presented with a proper notice, the dormant option matures into an enforceable


\(^5\) Buford, 105 S.W.3d at 673.

\(^6\) Id. at 673 (the owner must offer the burdened property to the rightholder on the terms and conditions specified in the contract containing the right).

\(^7\) Abraham, 968 S.W.2d at 524.

\(^8\) See Henderson v. Nitschke, 470 S.W.2d 410, 414 (Tex. Civ. App.—Eastland 1971, writ ref’d n.r.e.) (even though third-party purchaser revoked its offer to buy burdened lease, because owner gave notice to rightholder that it could buy the lease within 60 days on the same terms and conditions offered by the third party, owner could not revoke that offer).

\(^9\) Abraham, 968 S.W.2d at 524.

\(^10\) See, e.g., Riley v. Campeau Homes (Tex.) Inc., 808 S.W.2d 184, 187 (Tex. App.—Houston [14th Dist.] 1991, writ dism’d by agr.). If the agreement is interpreted as giving the rightholder merely the right to negotiate, it is an unenforceable agreement. Scott v. Ingle Bros. Pac., Inc., 489 S.W.2d 554, 555 (Tex. 1972).
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option\(^{11}\) and the rightholder has two choices: purchase the property on the terms and conditions specified in the notice or decline the offer and allow the owner to sell to a third party.\(^{12}\) If the rightholder attempts to change or qualify the terms of the offer, or otherwise fails to strictly comply with the terms of the notice, it risks having its action characterized as a rejection of the offer.\(^{13}\) Conversely, after the property owner gives the rightholder notice of its intent to sell, the terms of the option cannot be changed for as long as the option is binding on the property owner.\(^{14}\) If the rightholder accepts the offer, it becomes an enforceable contract.\(^{15}\) This is true even if the parties have agreed that a formal contract will be subsequently executed.\(^{16}\)

Rights of first refusal can be divided into two categories: specific price provisions and same terms and conditions provisions.\(^{17}\) In the former, the rightholder has the right to purchase

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\(^{11}\) *Riley*, 808 S.W.2d at 188.

\(^{12}\) *Martin v. Lott*, 482 S.W.2d 917, 922 (Tex. Civ. App.—Dallas 1972, no writ). *See also* *Crown Constr. Co., Inc. v. Huddleston*, 961 S.W.2d 552, 558 (Tex. App.—San Antonio 1997, no writ) (acceptance of an option must be unqualified, unambiguous, and strictly in accordance with the terms of the agreement).

\(^{13}\) *Hutchinson v. Cronin*, 426 S.W.2d 638, 641 (Tex. Civ. App.—Tyler 1968, no writ). *See also* *Crown Constr. Co., Inc. v. Huddleston*, 961 S.W.2d 552, 558 (Tex. App.—San Antonio 1997, no writ) (a failure to exercise an option according to its terms, including untimely or defective acceptance, is simply ineffectual and legally amounts to nothing more than a rejection).


\(^{16}\) *Sinclair Ref. Co. v. Allbritton*, 218 S.W.2d 185, 188 (Tex. 1949).

\(^{17}\) *W. Tex. Transmission v. Enron Corp.*, 907 F.2d 1554, 1562 (5\(^{\text{th}}\) Cir. 1990), *cert. denied*, 499 U.S. 906, 111 S.Ct. 1105, 113 L.Ed.2d 215 (1991). The court noted that most contracts base the sale price and other terms of the rightholder’s purchase contract on the bona fide offer made by a third party. *Id.* (citing *Sanchez v. Dickinson*, 551 S.W.2d 481, 485-86 (Tex. Civ. App. 1977, no writ); *Sinclair Ref. Co.*, 147 Tex. at 475, 218 S.W.2d at 188).
the burdened property for a specific price.\textsuperscript{18} In the latter, the rightholder has the right to purchase the property on the same terms and conditions agreed to by a third party.\textsuperscript{19} Whether because of the inherent ambiguity in an option that will be defined by a future agreement or because of their popularity as evidenced by the fact that the American Association of Petroleum Landmen ("AAPL") Model Form Operating Agreement uses a terms and condition provision, this type of provision is more commonly the subject of litigation than price provisions. Accordingly, this paper will focus primarily on terms and conditions provisions.

A. Purpose.

Preferential purchase right agreements between parties jointly developing oil and gas properties serve several purposes, including: (1) assuring the rightholder an opportunity to acquire future interests in the contract area, (2) fostering common development, (3) allowing those who contributed to the development of the property to enhance their interests in the area, (4) insuring some degree of control in excluding undesirable participants, and (5) fostering the original intent of the parties in developing the area by continuity of ownership.\textsuperscript{20} One

\textsuperscript{18} See, e.g., Kroehnke v. Zimmerman, 171 Colo. 365, 367, 467 P.2d 265, 266 (1970) ("[I]f during the term of this lease … the lessors … should desire to sell said demised premises, then the lessees … shall have the privilege of purchasing the same for the same price for which the lessors would be willing to sell to any other person.").

\textsuperscript{19} See, e.g., Holland v. Fleming, 728 S.W.2d 820, 822 (Tex. App.—Houston [1st Dist.] 1987, writ ref'd n.r.e.); Palmer v. Liles, 677 S.W.2d 661, 665 (Tex. App.—Houston [1st Dist.] 1984, writ ref'd n.r.e.); Sanchez, 551 S.W.2d at 484; Martin v. Lott, 482 S.W.2d 917, 920 (Tex. Civ. App.—Dallas 1972, no writ).

commentator has suggested that preferential purchase rights are the product of two basic motives. First, co-owners want to control who joins them in the financial and operational decisions and activities that are inherent in owning and operating the property. Second, the co-owners desire the chance to increase their holdings in the contract area if the properties are offered for an attractive price.21

There are reasons as well why parties may not want to include a preferential purchase right in their operating or other similar agreement. First, the provision may reduce the value of their interests.22 For example, a preferential right may increase the transactional costs associated with the sale of the burdened interest and, therefore, decrease any potential profit.23 Second, preferential purchase agreements have a tendency to limit marketability to the members of the original group.24 Third, in states that do not allow an owner to sell burdened property as part of a larger package, they limit the owner’s ability to market the burdened property.25 Finally, a preferential purchase provision may chill a potential purchaser’s interest in the property or lessen the price they would otherwise be willing to pay.26

B. AAPL Form 610.


22 Id..

23 Id.


26 Cross, supra note 21, at 195.
Rights of first refusal on oil and gas properties are frequently created by the joint operating agreement, a contractual arrangement between two or more parties for the joint development and operation of mineral properties. The most common preferential purchase provision is that found in the AAPL Form 610—Model Form Operating Agreement. The 1989 edition of the Model Form Agreement contains the following optional provision:

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

27 Conine, supra note 20, at 1268.

28 See Cross, supra note 21, at 195.
subsidiary or parent company or to a subsidiary of a parent company, or to any company in which such party owns a majority of the stock.  

The 1956 and 1982 Model Forms contain similar provisions, but there is a difference in their presentation. Prior to 1989, the preferential purchase provision was part of the form and parties  


30 The 1956 Model Form provides:  

Should any party desire to sell all or any part of its interests under this contract, or its rights and interests in the Unit Area, it shall promptly give written notice to the other parties, with full information concerning its proposed sale, which shall include the name and address of the prospective purchaser (who must be ready, willing and able to purchase), the purchase price, and all other terms of the offer. The other parties shall then have an optional prior right, for a period of ten (10) days after receipt of the notice, to purchase on the same terms and conditions the interest which the other party proposes to sell; and, if this optional right is exercised, the purchasing parties shall share the purchased interest in the proportions that the interest of each bears to the total interest of all purchasing parties. However, there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to dispose of its interests by merger, reorganization, consolidation, or sale of all of its interest, or to dispose of its interests by merger, reorganization, consolidation, or sale of all of its assets, or a sale or transfer of its interests to a subsidiary or parent company, or subsidiary of a parent company, or to any company in which any one party owns a majority of the stock.  

A.A.P.L. Form 610—Model Form Operating Agreement § 18 (Am. Ass’n Petroleum Landmen 1956). Note to editor, quoted in Cross at n.2.  

The 1982 Model Form provides:  

Should any party desire to sell all or any part of its interests under this agreement, or its rights and interests in the Contract Area, it shall promptly give written notice to the other parties, with full information concerning its proposed sale, which shall include the name and address of the prospective purchaser (who must be ready, willing
were required to strike it if they did not wish to utilize it. In the 1989 Form, the provision has a box next to it. Unless that box is checked, it is not included in the agreement.\textsuperscript{31}

Several basic observations can be made about this provision. First, it suggests that the preferential right is triggered solely by the seller’s subjective intent because it begins: “[s]hould any party desire to sell.” But because the owner is required to provide information on the prospective purchaser, it is clear that the provision requires an actual agreement to sell. Second, the provision requires more than mere mechanical compliance with a list of objective requirements. For example, it is not sufficient for a seller to photocopy an offer and insist upon a decision by the other parties to the joint operating agreement because the purchaser must be “ready, willing and able to purchase.” The seller cannot, therefore, engage in an act of bad faith by using a bogus offer in an attempt to pressure the other parties to purchase its interest. Third, the provision provides a relatively short decision window for the rightholders. They have ten days after the notice is delivered to purchase the offered property. Thus, they must make a decision and secure any necessary financing fairly quickly. Fourth, the provision does not define

\begin{quote}
A.A.P.L. Form 610—Model Form Operating Agreement art. VIII(f) (Am. Ass’n Petroleum Landmen 1982). Note to editor, quoted in Cross at n. 3. \end{quote}

\textsuperscript{31} Cross, \textit{supra} note 21, at 194 n.1.
“sell,” but because the authors felt it necessary to exclude mortgages, mergers, reorganizations, consolidations, and transfers to subsidiaries and parent companies, it can be easily argued that they intended a broad definition.

Oil and gas properties are frequently sold as part of a package containing several properties. It is easy to see how a package transaction can include multiple combinations of co-owners and properties burdened (or not) by diverse transfer restrictive provisions. It is noteworthy that despite the fact that the AAPL has had a Model Form Operating Agreement in place for over fifty years, has developed four versions of this agreement, and, presumably, has devoted countless hours to the development of this form, its preferential right to purchase provision has never specifically addressed package sales. Some have argued that this reflects the intent that the provision is not triggered by a package sale. Others, however, contend that the AAPL knows how to draft exclusions from the provision -- as reflected by the detailed exclusions that have been added over the years -- and conclude, therefore, that if it intended package transactions to be excluded it would have said so.

The authors found no reported decision that turned on the specific language of the AAPL’s Model Operating Agreements. A number of states have, however, considered the effect of a preferential purchase right covering one property conveyed as part of a larger package. Those decisions and their diversity of results will be discussed below.

C. Who is Subject to the Right?

32 Id. at 199.

33 See Reasoner, supra note 3, at 72 n. 10; Harlan Albright, Preferential Right Provisions and Their Applicability to Oil and Gas Instruments, 32 Sw. L.J. 803, 816 (1978).

34 Cross, supra note 21, at 199-200.
Obviously the original parties to the agreement and any third-party purchaser are subject to any preferential purchase provision covering the property being conveyed. Questions sometimes arise when the rightholder sells its interest or the owner sells the burdened property and the rightholder elects not to exercise its option. In the first instance, does the purchaser have a preferential purchase right in case of a subsequent sale by the new owner? In the second, does the rightholder still have a preferential purchase right? The answer generally depends on whether the preferential purchase provision is considered a covenant running with the land.

Whether a right of first refusal runs with the land depends on the specific wording of the contract provision.\textsuperscript{35} In general, there are four requirements for a contractual provision to run with the land: first, it must touch and concern the land; second, it must relate to a thing in existence or specifically bind the parties and their assigns; third, it must have been intended to run with the land by the original parties; and fourth, the successor to the burden must have notice.\textsuperscript{36} Conversely, personal covenants bind only the actual parties to the agreement.\textsuperscript{37}

In \textit{Stone v. Tigner},\textsuperscript{38} the lessee of a grazing lease had a right of first refusal to purchase the leased premises in the event of a sale of that land to a third party. The owner subsequently entered into an agreement with a third-party buyer to sell the burdened property.\textsuperscript{39} The owner

\begin{footnotesize}
\textsuperscript{35} Startex First Equip., Ltd. v. Aelina Enters., Inc., 208 S.W.3d 596, 600 (Tex. App.—Austin 2006, no pet.).

\textsuperscript{36} First Permian, L.L.C. v. Graham, 212 S.W.3d 368, 372 (Tex. App.—Amarillo 2006, no pet.) (citing Inwood N. Homeowners’ Ass’n, Inc. v. Harris, 736 S.W.2d 632, 635 (Tex. 1987)).

\textsuperscript{37} Veterans Land Bd. V. Lesley, 281 S.W.3d 602, 621 (Tex. App.—Eastland 2009, pet. granted); Montford v. Trek Res., Inc., 198 S.W.3d 344, 355 (Tex. App.—Eastland 2006, no pet.).

\textsuperscript{38} 165 S.W.2d 124, 125 (Tex. Civ. App.—Galveston 1942, writ ref’d).

\textsuperscript{39} Id. at 125-26.
\end{footnotesize}
provided notice to the rightholder, and the rightholder notified the owner that he intended to exercise his right of first refusal.\(^{40}\) Nevertheless, the owner sold the property to the third party. The deed made no mention of the grazing lease.\(^{41}\) The Galveston Court of Appeals framed the issue as whether the right of first refusal was absolute or whether it arose only when the owner agreed to sell the land free and clear of the rightholder’s lease. The court held that the right of first refusal was an absolute prior right that ran with the land.\(^{42}\) Consequently, the rightholder had an absolute and prior right to purchase the leased land for the price offered by the third party.

In *McMillan v. Dooley*,\(^ {43}\) the court held that a preferential right contained in a farmout agreement was a covenant running with the land. The preferential right was reserved for the assignor of the lease as well as the assignor’s successors and assigns.\(^ {44}\) The right was triggered when the assignee or the assignee’s heirs, successors, or assigns attempted to sell any portion of the lease assigned by the agreement, plugged and abandoned any wells on the lease, or plugged and abandoned the lease.\(^ {45}\)

A right of first refusal has also been held to run with the land when it was found in a lease that subjected subsequent sales of the leased property to the lease’s terms.\(^ {46}\) Similarly, a right of first refusal was held to run with the land when a contractual provision required the owner or his

\(^{40}\) *Id.* at 126.

\(^{41}\) *Id.*

\(^{42}\) *Id.* at 127.

\(^{43}\) 144 S.W.3d 159 (Tex. App.—Eastland 2004, pet. denied).

\(^{44}\) *Id.* at 164, 165.

\(^{45}\) *Id.*

transferee to perform all terms, covenants, and conditions of the contract, including the right of first refusal.\textsuperscript{47}

D. How Long Does the Right Exist?

At least in Texas there does not appear to be a general limitation on the length of time a preferential purchase right agreement can exist. But in a particular case, an owner may attempt to challenge the validity of a preferential right as an unreasonable restraint on alienation. The Restatement of Property describes a right of first refusal as a promissory restraint on alienation.\textsuperscript{48} The question, then, is whether the restraint is unreasonable.\textsuperscript{49} In \textit{Forderhause v. Cherokee Water Co.},\textsuperscript{50} the court held that a right of first refusal was not an unreasonable restraint on alienation if it was exercisable only when the owner decided to sell the property and only if the rightholder met the terms of a bona fide offer.

\textit{Navasota Resources, L.P. v. First Source Texas, Inc.}\textsuperscript{51} involved a right of first refusal in an AAPL Form 610-1989 operating agreement. The Waco Court of Appeals applied the Restatement (Third) of Property to determine whether the restraint on alienation was

\textsuperscript{47} 6500 Cedar Springs L.P. v. Collector Antique, Inc., No. 05-98-00386-CV, 2000 WL 1176586, at *3 (Tex. App.—Dallas August 21, 2000, no pet.).

\textsuperscript{48} See \textit{Navasota Res.}, L.P. v. First Source Tex., Inc., 249 S.W.3d 526, 538 (Tex. App.—Waco 2008, pet. denied); Perritt Co. v. Mitchell, 663 S.W.2d 696, 698 (Tex. App.—Fort Worth 1983, writ ref’d n.r.e.).

\textsuperscript{49} \textit{Navasota Res.}, 249 S.W.3d at 538.

\textsuperscript{50} 623 S.W.2d 435, 439 (Tex. Civ. App.—Texarkana 1981), \textit{rev’d on other grounds}, 641 S.W.2d 522, 526 (Tex. 1982).

\textsuperscript{51} 249 S.W.3d at 529.
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unreasonable. Under the Restatement, a restraint’s reasonableness is to be determined “by weighing the utility of the restraint against the injurious consequences of enforcing the restraint.” Moreover, “[i]f the right to purchase is on the same terms and conditions as the owner may receive from a third party, if the procedures for exercising the right are clear, and if the period within which it must be exercised is relatively short, the right of first refusal is valid unless the purpose is not legitimate.” The court held that the right of first refusal contained in the operating agreement was not an unreasonable restraint on alienation.

It is important to remember that the preferential right is not extinguished by a sale of the burdened property. The failure to exercise the right in one transaction does not preclude its proper exercise as to subsequent sales. Consequently, a purchaser from a lessor who has given a right of first refusal takes the property subject to that right. It is, therefore, important for parties acquiring an interest subject to a pre-existing joint operating agreement to review the terms of that agreement to determine if their purchase is burdened by a preferential purchase provision.

E. What Triggers the Owner’s Duty to Give Notice?

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52 Id. at 538 (citing RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.4, cmt. F (2004)).
53 Id.
54 Id.
55 Id. at 539.
56 Foster v. Bullard, 496 S.W.2d 724, 736 (Tex. Civ. App.—Austin 1973, writ ref’d n.r.e.).
58 See Westland Oil Dev. Corp. v. Gulf Oil Corp., 637 S.W.2d 903, 908 (Tex. 1982) (purchaser charged with notice of the terms of an operating agreement referenced in their chain of title).
The AAPL Model Form Operating Agreement preferential purchase provisions begin: “[s]hould any party desire to sell all or any part of its interest.” This would suggest that the right is triggered by the owner’s subjective intent to sell. And there are at least two cases that describe the owner’s duty to provide notice as arising when it decides to sell.59 Upon closer examination, however, the most recent decision relies upon secondary authority describing the owner’s duty when the rightholder has a preferential right to purchase for a specific price.60 Elsewhere in the opinion the court described the owner’s duty as requiring it to provide the rightholder with an opportunity to buy the burdened property on the terms offered by a bona fide purchaser and held that until an offer was made, the owner had no duty to act.61 In the earlier decision each of the justices wrote separately and only one justice said that no third party purchaser was required.62

Most courts have looked not to the owner’s subjective intent but to its actions and to the totality of the transaction to determine whether a sale has occurred.63 For example, preliminary negotiations between offerors and potential purchasers do not trigger preemptive rights.64 Unless expressly provided otherwise in the agreement, an actual sale is required. This makes sense if


60 The court relied upon an American Jurisprudence provision stating that the owner “when and if he decides to sell, [must] offer the property first to the person entitled to the pre-emptive right at the stipulated price.” 551 S.W.2d at 484(citing 77 Am. Jur.2d Vendor & Purchaser § 49 (1975)).

61 Sanchez, 551 S.W.2d at 486.

62 Mecom, 213 S.W.2d at 305.

63 See, e.g., Rainbow Oil Co. v. Christmann, 656 P.2d 538 (Wyo. 1982).

for no other reason than until the parties have agreed to all of the material terms, there is no enforceable contract.\textsuperscript{65} Thus, negotiations alone may indicate what the seller wants, but because the rightholder’s option is defined by the terms of an agreement, they are not a triggering event. The AAPL model operating agreements do not define the term “sell” but courts have applied a more narrow interpretation than simply a transfer of title and, instead, have required an actual sale.\textsuperscript{66} Actual sales are characterized by arms-length transactions and transfers of consideration.\textsuperscript{67}

In Texas, an oil and gas lease constitutes a sale for purposes of the preferential purchase right.\textsuperscript{68} In \textit{Cherokee Water Co. v. Foderhause},\textsuperscript{69} the preferential right was created by a deed that conveyed the surface and reserved the minerals. That deed read:

Grantee is hereby given the first option to purchase the oil, gas and other minerals herein reserved, at the same price and on the same terms as Grantor has agreed to sell to a third party.\textsuperscript{70}

The court of appeals found this language was ambiguous\textsuperscript{71} but the Supreme Court disagreed.\textsuperscript{72} The court held that the term “sale,” when used in a property context, is commonly understood to

\begin{itemize}
  \item \textsuperscript{66} \textit{Rainbow Oil}, 656 P.2d at 544 (citing Durkee v. Durkee-Mower, Inc., 428 N.E.2d 139 (Mass. 1981)).
  \item \textsuperscript{67} \textit{See Rainbow Oil}, 656 P.2d at 543 (citing Kroehnke v. Zimmerman, 467 P.2d 265, 267 (Colo. 1970) (sales are characterized by arms length dealing between a willing seller and a willing buyer neither of which is forced into the transaction); McLeod v. Sandy Island Corp., 216 S.E.2d 746, 749 (S.C. 1975) (distinguishing between gifts and sales by the transfer of consideration)).
  \item \textsuperscript{68} \textit{Cherokee Water Co. v. Foderhause}, 641 S.W.2d 522, 525 (Tex. 1982).
  \item \textsuperscript{69} \textit{Id.} at 522.
  \item \textsuperscript{70} \textit{Id.} at 524.
\end{itemize}
mean any conveyance of an estate for money or money’s worth, and that an oil and gas lease is a sale of interest in land. The court held that a sale would include a purchase of a fee simple, a determinable fee, a fee subject to a condition subsequent, and a life estate.\textsuperscript{73}

The following transactions are typically excluded from operation of a preferential purchase right:

- Mortgage of the interest;\textsuperscript{74}
- Transfers by descent or public sales by administrators;\textsuperscript{75}
- Transfer of the interest in lieu of or pursuant to foreclosure;\textsuperscript{76}
- Transfers between family members without consideration;\textsuperscript{77}
- Disposition of a party’s interests by merger, reorganization, or consolidation;\textsuperscript{78}
- Judicial sales;\textsuperscript{79}


\textsuperscript{72} 641 S.W.2d at 523.

\textsuperscript{73} Id. at 525.

\textsuperscript{74} Draper v. Gochman, 400 S.W.2d 545,545 (Tex. 1966).


\textsuperscript{76} Conine, supra note 20, at 1319; but see Price v. Town of Ruston, 132 So. 653 (La. 1931) (preferential purchase right triggered by foreclosure sale).

\textsuperscript{77} Exeter Exploration Co. v. Fitzpatrick, 661 P.2d 1255, 1259 (Mont. 1983).

\textsuperscript{78} See, e.g., Engel v. Teleprompter Corp., 703 F.2d 127, 134-35 (5th Cir. 1983).
Transfers from cotenant to another;\(^{80}\)

Sale of all of the owner’s stock;\(^{81}\) or

Transfer of a party’s interests to an affiliate.\(^{82}\)

For example, in *Texas Co. v. Graf*, a sale by one cotenant to another did not trigger a preferential purchase right.\(^{83}\) In *Tenneco Inc. v. Enterprise Products Co.*, the Texas Supreme Court found that a preferential purchase right in a gas plant operating agreement was not triggered by a stock sale.\(^{84}\) The preferential right was defined as:

*Preferential Right to Purchase.* Except as provided in Section 12.6 hereof, if any Owner should desire to sell, transfer or assign any part of its Ownership Interest, the other Owners shall have the prior and preferential right and option to purchase proportionately the interest to be sold by such Owner upon the same terms and conditions.

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\(^{80}\) Tex. Co. v. Graf, 221 S.W.2d 865, 866 (Tex. Civ. App.—Fort Worth 1949, writ ref’d).

\(^{81}\) Cruising World Inc. v. Westermeyer, 351 So. 2d 371 (Fla. App. 1977) (purchasing corporate stock is distinct from purchasing a corporation's individual assets).

\(^{82}\) Questa Energy Corp. v. Vantage Point Energy, Inc., 887 S.W.2d 217, 222 (Tex. App.—Amarillo 1994, writ denied) (burdened property’s transfer from subsidiary to parent corporation did not trigger preferential right); Roeland v. Trucano, 214 P.3d 343, 352 (Alaska 2009) (burdened property’s transfer from grantor corporation to a limited liability company owned by the corporation’s shareholder did not trigger preferential purchase right).

\(^{83}\) 221 S.W.2d 865, 866 (Tex. Civ. App.—Fort Worth 1949, writ ref’d); *see also* Wilson v. Grey, 560 S.W.2d 561 (Ky. 1978); Baker v. McCarthy, 443 A.2d 138, 141 (N.H. 1982).

\(^{84}\) 925 S.W.2d 640 (Tex. 1996).
conditions as the bona fide prospective purchaser or purchasers (collectively “Offeror”) are offer by such Owner …. \textsuperscript{85}

The parties originally discussed an asset sale from Tenneco Oil to Enron Gas Processing. What was ultimately consummated, however, was a sale by Tenneco Oil of all of Tenneco Natural Gas Liquids’ stock to Enron Gas Processing Company.\textsuperscript{86} In the interim, Tenneco conveyed its share of the plant to Tenneco Gas Liquids, a wholly-owned subsidiary of Tenneco. After the stock sale, Enron changed the company’s name to Enron Natural Gas Liquids and sold its stock to Enron Liquids Pipeline Operating Limited Partnership.

Enterprise did not argue that the transfer from Tenneco to Tenneco Gas Liquids triggered the preferential right but did argue that the stock sale to Enron and Enron’s stock sale to the limited partnership were triggering events. The Supreme Court found that the agreement created a preferential right when there was an asset sale but not when there was a stock transfer or other change-of-control transaction.\textsuperscript{87} The court noted that the agreement spoke to transfers of ownership interest but said nothing about changes in stockholders.\textsuperscript{88} Because the agreement did not speak to stock sales and because no other change-of-control mechanisms were identified as triggers, it could not imply an intention to trigger the preferential right because of changes in control.\textsuperscript{89}

The court’s analysis relies upon traditional contract interpretation principles but it indicates that it was also influenced by the fact that preferential purchase rights restrict property

\textsuperscript{85} Id. at 644.
\textsuperscript{86} Id. at 642.
\textsuperscript{87} Id. at 645.
\textsuperscript{88} Id.
\textsuperscript{89} Id. at 646.
The court noted that the parties could have included a change-of-control provision but did not and, therefore, that it would be improper to imply a restraint for which the parties have not bargained. Arguably, it is never appropriate for a court to imply a term the parties could have included but did not. But the court did not say that. It instead specifically noted the impropriety of implying a restraint. It could be, therefore, that the court will more strictly construe the scope of a preferential purchase right than other contract provisions. Or, the court may have placed more reliance on the commentators who, it noted, “have long maintained that stock sales do not invoke preemptive rights” absent specific language to the contrary.

In Texas, the right of first refusal is not triggered by a foreclosure sale but it does survive the transaction and burdens the property interest as to future sales by the new owners. This issue arose when a lessee’s interest in real property was sold at a foreclosure sale. A sublease contained a preferential right to purchase if and when the lessee “wishes to sell or dispose of his

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90 Id. (courts narrowly construe rights of first refusal and other provisions that effectively restrict the free transfer of stock)(citing Consol. Bearing & Supply Co. v. First Nat’l Bank, 720 S.W.2d 647, 650 (Tex. App.—Amarillo 1986, no writ); Gulf States Abrasive Mfg. v. Oertel, 489 S.W.2d 184, 187 (Tex. Civ. App.—Houston [1st Dist.] 1972, writ ref’d n.r.e.)).

91 925 S.W.2d at 646.

92 Id.

93 Id. (citing Conine, supra note 20, at 1320, 1320 n. 231; Reasoner, supra note 3, at 72; Abright, supra note 33, at 811-12.

94 Draper v. Gochman, 400 S.W.2d 545, 548 (Tex. 1966).
interest." The Texas Supreme Court held that because the preferential right was triggered by the lessee’s desire to sell, it was not applicable to an involuntary sale.

F. What Notice Must Be Given?

As a general rule, the rightholder is entitled to: notice when the owner intends to sell the property, information about the terms and conditions of that sale, and a reasonable period within which to accept or reject the offer. The AAPL model operating agreement requires the owner to provide the name and address of the purchaser, the purchase price, a legal description sufficient to identify the property, and all other terms of the offer. The manner of providing notice and the required contents of that notice depend upon the terms of the contract. Some contracts require the owner to offer the property for sale to the rightholder before soliciting offers from any independent party. Other contracts require the owner to communicate any third party offer to the rightholder and permit the rightholder to match that offer. Finally, some

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95 Id at 545.
96 Id. at 548 (trustee’s sale was not a voluntary sale and, therefore, did not trigger the preferential right to purchase agreement).
98 A.A.P.L. Form 610-Model Form Operating Agreement art. VIII(F) (Am. Ass’n Petroleum Landmen 1989).
99 Cross, supra note 21, at 203.
owners need only forward to the rightholder the terms and conditions of those offers which they are willing to accept. If the rightholder duplicates those terms, it acquires the property.\(^{101}\)

Preferential rights provisions contemplate the owner giving the rightholder actual notice. In some instances, however, the owner’s notice requirement can be satisfied if the rightholder obtains actual or inquiry notice by some other means. For example, seeing a copy of an assignment conveying the burdened interest\(^{102}\) or receiving a letter notifying the rightholder of a sale of property he knew was burdened by his preferential right even though it did not include a legally sufficient property description.\(^{103}\) Similarly, an otherwise insufficient written notice can be cured if the rightholder is verbally informed of all of the required information.\(^{104}\)

G. Is the Right Impacted by Unique Terms and Conditions?

In *West Texas Transmission, L.P. v. Enron Corporation*,\(^{105}\) the court considered whether a rightholder could be forced to meet a condition imposed upon a third-party purchaser. From 1969 until 1985, Valero Transmission Company owned and operated the TransTexas Natural

\(^{101}\) Henderson v. Nitschke, 470 S.W.2d 410, 413 (Tex. Civ. App.—Eastland 1971, writ ref’d n.r.e.) (when owner sends out notice it becomes an option and when accepted by the rightholder it becomes a binding contract).

\(^{102}\) See, e.g., Exeter Exploration Co. v. Fitzpatrick, 661 P.2d 1255, 1258 (Mont. 1983) (rightholder was required to timely exercise his preferential purchase right after seeing a copy of an assignment transferring the burdened property).

\(^{103}\) Humphrey v. Wood, 256 S.W.2d 669, 672 (Tex. Civ. App.—Amarillo 1953, writ ref’d n.r.e.).

\(^{104}\) Mecom v. Gallagher, 213 S.W.2d 304, 306 (Tex. Civ. App.—El Paso 1947, no writ) (rightholder was given sufficient information when he received a notice letter and then met with a representative of the owner and the third-party purchaser where the “whole matter of the sale was discussed.”).

Gas Pipeline. In 1985, it entered into a joint venture with NorTex, a wholly owned subsidiary of InterNorth, Inc. Valero contributed a one-half interest in the pipeline and NorTex contributed long-term gas supply and working capital. Both parties had a right of first refusal on the sale of the pipeline.\textsuperscript{106} InterNorth merged with Houston Natural Gas to form Enron, Inc. HNG was a competitor of Valero. Valero filed suit to block the merger. Valero and Enron settled, with Enron agreeing to sell its pipeline interest to a purchaser acceptable to Valero.\textsuperscript{107}

The Federal Trade Commission investigated the InterNorth/HNG merger and it formulated a consent decree that allowed the merger to proceed but required the parties to divest themselves of certain assets including the TransTexas Pipeline. The FTC also required the parties to seek its approval of any divestiture.\textsuperscript{108} Valero reorganized and assigned its pipeline

\textsuperscript{106} Id. at 1556. That right was as follows:

9.1 \textit{Right of First Refusal.} In the event either Party desires to sell or transfer all or part of its undivided interest in the System to an entity other than an affiliated entity of that Party and receives or solicits a bona fide offer or agreement from a prospective purchaser (who must be ready, willing, and able to purchase) that such Party is willing to accept, then the Party desiring to sell or transfer such interest shall first give written notice of the proposed sale to the other Party, such notice to set forth the terms and condition of such proposed sale and the name and address of the prospective purchaser. The other party shall then have a prior right, for a period of sixty (60) days after receipt of such notice, to agree to purchase such interest on the same terms and conditions as set forth in such offer or agreement to purchase.

\textsuperscript{107} Id. at 1556.

\textsuperscript{108} Id. at 1556-57.
interest to a wholly owned subsidiary, West Texas Transmission, L.P. Enron agreed to sell its NorTex stock, including the TransTexas Pipeline interest to TECO Pipeline Company. The sale was conditioned on FTC approval and on Valero not exercising its right of first refusal. Valero did elect to exercise its right of first refusal and it signed a contract with Enron that was identical to the TECO agreement except for the names of the parties. The FTC failed to approve Valero’s acquisition before the purchase agreement expired.

Enron and TECO negotiated a second stock purchase agreement. This agreement also required FTC approval and Valero’s decision to not exercise its right of first refusal. Valero exercised that right and it and Enron executed a new contract substituting Valero’s name for TECO. The FTC disapproved the sale to Valero because of concerns over the impact this would have on the concentration of companies moving gas out of the Permian Basin and the number of companies economically able to supply natural gas to the San Antonio area. It did, however, approve the sale to TECO.

The court was required to decide whether Enron could condition Valero’s exercise on FTC approval. The court noted that the contract did not limit Enron’s ability to include specific conditions in any offer but only required Enron to offer the pipeline interest to Valero on the same terms and conditions imposed upon a third-party. Thus, the court concluded that Enron

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109 Id. at 1557.
110 Id.
111 Id. at 1558.
112 Id.
113 Id. at 1559-60.
114 Id. at 1563. The court cited Joe T. Garcia’s Enter. v. Snadon, 751 S.W.2d 914, 916 (Tex. App.--Dallas 1988, writ denied), for the proposition that the terms and conditions under which Valero could acquire the pipeline remained
was free to strike its best deal and then “to require Valero to match that bargain.”\textsuperscript{115} Including FTC approval was well within Enron’s prerogative.\textsuperscript{116}

To this point, the court’s opinion is not particularly remarkable. Enron was subject to a FTC order requiring regulatory approval of any divestiture. Consequently, requiring Valero to meet this condition seems reasonable. Indeed, one could infer into any preferential purchase provision a requirement that the exercise of that right satisfy any applicable legal or regulatory requirement. The court, however, continued its analysis by considering what terms or conditions could be imposed. The court concluded that Enron could impose any condition that was:

(1) commercially reasonable;

(2) imposed in good faith; and

(3) not specifically designed to defeat the preemptive right.\textsuperscript{117}

This holding has prompted some criticism.\textsuperscript{118} The court was applying Texas law and it cited \textit{Holland v. Fleming},\textsuperscript{119} but it also cited decisions from California, Kentucky, Rhode Island, Utah, and Washington.\textsuperscript{120} The remainder of the court’s analysis relies heavily on out-of-state

\textsuperscript{115} W. Tex. Transmission, 907 F.2d at 1563.

\textsuperscript{116} Id.

\textsuperscript{117} Id.


\textsuperscript{119} 728 S.W.2d 820, 823 (Tex. Civ. App.—Houston [1st Dist.] 1987, writ ref’d n.r.e.).

\textsuperscript{120} The court cited McCulloch v. M & C Beauty Collins., 240 Cal. Rptr. 189 (Ct. App. 1987); Brownies Creek Collieries, Inc v. Asher Coal Mining Co., 417 S.W.2d 249, 252 (Ky. Ct. App. 1967); Hood v. Hawkins, 478 A.2d
authority. In fact, based solely on out-of-state authority, the court held that the reasonableness of a condition was determined by examining the circumstances of each case\textsuperscript{121} and that requiring outside approval of an agreement, such as financing or credit-worthiness, was routine and comparable to the FTC approval requirement.\textsuperscript{122} The court also held that most courts have insisted that purchasers replicate a myriad of non-price conditions.\textsuperscript{123} None of these cases, however, were Texas decisions.

Texas Courts have been critical of the Fifth Circuit’s three-part test. In \textit{Abraham Investment Company v. Payne Ranch, Inc.},\textsuperscript{124} the Amarillo Court of Appeals was faced with an argument by a rightholder that a notice letter was not commercially reasonable or a bona fide offer, and that its terms were designed to defeat his preferential right. The court described the Fifth Circuit’s three-part test as “exceptions based in large part upon the law of other jurisdictions.”\textsuperscript{125} The court declined to apply these exceptions but deferred to Texas law. It described Texas law as allowing equitable relief when the offeree fails to accept an offer due to

\textsuperscript{121} 907 F.2d at 1563 (citing Prince v. Elm Inv. Co., Inc., 649 P.2d 820, 825 (Utah 1982)).

\textsuperscript{122} 907 F.2d at 1563 (citing \textit{McCulloch}, 240 Cal. Rptr. at 189; Keys Lobster v. Ocean Divers, 468 So.2d 360, 362 (Fla. Dist. Ct. App. 1985), \textit{rev. denied}, 480 So.2d 1295 (1985)).

\textsuperscript{123} The court cited \textit{McCulloch}, 240 Cal. Rptr. at 189; \textit{Keys Lobster}, 468 So.2d at 362 (requiring adequate credit and special payment terms); Fallenius v. Walker, 787 P.2d 203, 205 (Colo. App. 1989) (assumption of real estate commissions); \textit{Prince}, 649 P.2d at 823-26 (additional partnership and land development obligations); \textit{Matson}, 676 P.2d at 1033 (the exchange of land parcels rather than a cash transaction); Crow-Spieker No. 23 v. Robert L. Helms Constr. and Dev. Co., 731 P.2d 348, 350 (Nev. 1987) (the purchase of a larger quantity of land).

\textsuperscript{124} 968 S.W.2d 518, 526 (Tex. App.—Amarillo 1998, pet. denied).

\textsuperscript{125} \textit{Id.} at 527.
fraud, surprise, accident, or mistake. Additionally, equitable relief may be appropriate if the offerror’s conduct prevented the offeree from properly making his acceptance. One can argue that the court was not concerned about the reasonableness of the offer but was, instead, concerned about the reasonableness of the owner and third party’s conduct – particularly when that conduct interfered with the rightholder’s ability to exercise its contractual rights.

A Houston Court of Appeals applied the Fifth Circuit’s three-part test over the dissent of one justice in *Texas State Optical v. Wiggins*. Justice Cohen was the dissenter. He argued that the Fifth Circuit did not follow Texas law but created new law. Justice Cohen was critical of the Fifth Circuit’s reliance on *Holland v. Fleming*, contending that the opinion provided no authority for the court’s test. Justice Cohen was also critical of the Fifth Circuit’s pronouncement that if an owner complies with its test that the rightholder has no ability to remove any condition or extract any concession, because the court cited no supporting authority.

It is difficult to see where the Fifth Circuit found any support for its three-part test in *Holland v. Fleming* because it is absent any discussion of the terms or conditions that an owner can impose. Holland and Fleming executed a grazing lease that contained a right of first refusal if Holland sold the property before the end of the lease. Holland contracted to sell the tract but two days later the agreement was cancelled by mutual consent. Fleming learned of the agreement and notified Holland that he was exercising his right of first refusal. Holland rejected

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126 Id( citing Jones v. Gibbs, 130 S.W.2d 265,272-73 (Tex. 1939)).

127 Id.

128 882 S.W.2d 8, 11, 12 (Tex. App.—Houston [1st Dist.] 1994, no writ).

129 Id. at 12.

130 Id. at 12-13.
Fleming’s claim. Fleming then filed suit for specific performance.\textsuperscript{131} The question before the court was whether Fleming’s preferential right matured into an enforceable option. The court held that a property owner is not required to give notice when it first forms the intent to sell but must give notice within a reasonable amount of time after executing a sales agreement. Because the sales agreement was canceled shortly after its execution, Holland had no duty to notify Fleming and, therefore, his preferential right never matured into an enforceable option.\textsuperscript{132}

In \textit{Navasota Resources L.P. v. First Source Texas, Inc.},\textsuperscript{133} the Waco Court of Appeals dealt with the issue of whether the holder of a right of first refusal in oil and gas interests subject to a joint operating agreement had to purchase common stock and enter into a 13-county area of mutual interest agreement as a condition to the exercise of its preferential right. The court distinguished \textit{West Texas Transmission} by noting that it involved the conveyance of a single asset rather than a package deal with multiple assets.\textsuperscript{134} Two cases cited by \textit{West Texas Transmission} were also addressed. First, the court distinguished \textit{Prince v. Elm Investment Co., Inc.}\textsuperscript{135} by pointing out that it dealt with the contribution of a single, burdened tract to a partnership as consideration for an interest in the partnership and thus was not necessarily relevant to package transactions.\textsuperscript{136} Second, the court criticized \textit{West Texas Transmission}’s

\textsuperscript{131} Holland v. Fleming, 728 S.W.2d 820, 821 (Tex. App.—Houston [1st Dist] 1987, writ ref’d n.r.e.).

\textsuperscript{132} \textit{Id.} at 823.

\textsuperscript{133} 249 S.W.3d 526, 529, 535 (Tex. App.—Waco 2008, pet. denied).

\textsuperscript{134} \textit{Id.} at 536.

\textsuperscript{135} 649 P.2d 820 (Utah 1982).

\textsuperscript{136} \textit{Navasota Res.}, 249 S.W.3d at 536.
reliance on *Crow-Spieker No. 23 v. Robert L. Helms Construction & Development Co.*,\(^{137}\) by describing the portion of the decision cited by the Fifth Circuit as an alternative holding and contrary to most authority on the issue.\(^{138}\) Thus, the court held that the rightholder could not be required to purchase common stock and enter into an area of mutual interest agreement as a condition to the exercise of its right.\(^{139}\) In other instances, Texas Courts have noted the criticism of *West Texas Transmission* and then distinguished it factually.\(^{140}\)

Nevertheless, in *FWT Inc. v. Haskin Wallace Mason Property Management, L.L.P.*\(^{141}\) the Fort Worth Court of Appeals followed *West Texas Transmission*’s three factor test in a package deal that conditioned the exercise of a right of first refusal to a tract of land on the purchase of the assets of galvanizing businesses that the owner had built on the tract. While the court acknowledged that the test in *West Texas Transmission* had been applied to cases involving a single asset, it saw no reason not to apply it to cases involving multiple assets.\(^{142}\) It addressed some of the concerns the Waco Court of Appeals raised about *West Texas Transmission*’s applicability to package transactions by reshaping the Fifth Circuit’s commercial reasonableness factor into a question of whether the assets as a whole are related.\(^{143}\) The court concluded that the assets involved in *Navasota* were minimally related and severable from the asset subject to

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\(^{137}\) 731 P.2d 348, 350 (Nev. 1987) (stating in relevant part that terms and conditions to exercising a right of first refusal in a package sale of land included purchasing the entire package).

\(^{138}\) *Navasota Res.*, 249 S.W.3d at 536-37.

\(^{139}\) *Id.* at 537.

\(^{140}\) *See, e.g.*, McMillan v. Dooley, 144 S.W.3d 159,177 (Tex. App.—Eastland 2004, pet. denied).

\(^{141}\) 301 S.W.3d 787, 790, 801-02 (Tex. App.—Fort Worth 2009, pet. denied).

\(^{142}\) *Id.* at 802.

\(^{143}\) *Id.* at 802 n. 17.
the preferential right. The assets of the galvanizing businesses, however, were situated directly on the tract subject to the right. Because the galvanizing businesses’ assets made up over 90% of the total purchase price, the possibility that the rightholder might exercise its right of first refusal likely played little or no part in the parties’ decision to condition the purchase or lease of the property on the purchase of the galvanizing businesses’ assets. The court, therefore, held that the condition was commercially reasonable, was imposed in good faith, and was not designed to defeat the right of first refusal.

To the question “Can a preferential right be impacted by unique terms and conditions?”, the answer is apparently: it depends. Parties should consider whether the unique terms and conditions are imposed by law or regulatory authority, whether they are directly associated with the burdened property, whether their inclusion or exclusion unfairly impacts the rightholder, and whether they serve a legitimate business interest of the seller.

For example, assume that the seller is concerned about future environmental liability and does not want to sell its interest to anyone financially unable to cover the costs of properly plugging the wells and performing any necessary remediation. Alternatively, it is concerned about future liability for unpaid operational expenses. Consequently, the seller includes a credit worthiness requirement in the sales agreement. The rightholder cannot satisfy this requirement but can match the third party’s cash offer. The seller could argue that the

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144 Id.
145 Id. at 802.
146 Id. at 803.
147 See Seagull Energy E&P, Inc. v. Eland Energy, Inc., 207 S.W.3d 342 (Tex. 2006) (Eland Energy was jointly and severally liable for operational costs associated with working interests it assigned to a third-party that were incurred after the assignment).
consideration offered by the third party was not only the purchase price but also an indemnity agreement that, because of the third party’s credit worthiness, has additional value. If true, the seller’s argument has some face value. However, it is not difficult to imagine a situation where such a requirement was drafted after the seller reached an agreement with a third party and was defined in such a way as to defeat the rightholder’s preferential right. Whether the seller can successfully insist upon this particular requirement is unclear because this question has not yet been addressed. Obviously the answer will be heavily dependent upon the facts of each individual case. The question does, however, offer a glimpse into the myriad of conditions that could be fairly included in a transaction but at the same time be easily inserted merely to defeat a preferential right.

H. How is a Right of First Refusal Exercised?

A purchase option is largely for the benefit of the optionee and must be construed with this fact in mind. Thus, the general rule is that the rightholder must strictly comply with the terms of the offer. If the manner of acceptance is specified in the notice, then the rightholder must accept in the manner specified or risk waiving the right of first refusal. The acceptance must be unconditional and unequivocal. A failure to unconditionally accept the terms, and in the manner specified, constitutes a rejection of the offer and a waiver of the right of first refusal.

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149 See, e.g., Pinchin v. Kinney, 623 S.W.2d 783, 783 n.3 (Tex. App.—Austin 1981, no writ) (optionee required to respond in terms that were definite, positive, unconditional, unequivocal and consistent with the terms of the offer).
refusal.\textsuperscript{151} Texas has been strict in requiring adherence to the owner’s offer but other jurisdictions have been more lenient. For example, in Ohio the rightholder need only accept the material terms of the offer.\textsuperscript{152}

\textbf{III. COMPLICATIONS CAUSED BY PACKAGE TRANSACTIONS.}

As one commentator has noted, package deals are one of the most common oil and gas transactions, and they fall within the language commonly used in preferential rights provisions, yet the standard provisions do not comprehend multi-interest deals in which no specific offer is made for the burdened interest.\textsuperscript{153} As previously noted, the AAPL’s Model Operating Agreements do not specifically address package transactions in their preferential purchase provisions. Understandably, then, the presence of preferential purchase provisions burdening some, but not all, of the properties being sold in a package deal has generated considerable question and confusion.

\textsuperscript{151} Comeaux v. Suderman, 93 S.W.3d 215, 220 (Tex. App.—Houston [14\textsuperscript{th} Dist.] 2002, no pet.).

\textsuperscript{152} Davis v. Iofredo, 713 N.E.2d 26, 28 (Ohio Ct. App. 1998) (right of first refusal need only be exercised upon the same material or essential terms). \textit{See also} C. Robert Nattress \& Assocs. v. Cidco, 229 Cal. Rptr. 33 (Ct. App. 1986) (exercising right of first refusal requires producing the same net effect of the triggering offer to the owner, not a literal matching of forms); Vincent v. Doebert, 539 N.E.2d 856 (Ill App. Ct. 1989); Brownies Creek Collieries, Inc. v. Asher Coal Mining Co., 417 S.W.2d 249 (Ky. Ct. App. 1967) (right of first refusal for minor variations in the terms); Prince v. Elm Inv.. Co., 649 P.2d 820 (Utah 1982); Nw. Television Club, Inc. v. Gross Seattle, Inc., 640 P.2d 710 (Wash. 1981); Matson v. Emory, 676 P.2d 1029 (Wash. Ct. App. 1984);

\textsuperscript{153} Albright, \textit{supra} note 33, at 816.
The first question that must be answered is whether selling a burdened property as part of a larger package even triggers the right of first refusal. Courts in Colorado,\textsuperscript{154} Idaho,\textsuperscript{155} Iowa,\textsuperscript{156} Aden v. Hathaway’s Estate, 427 P.2d 333, 334 (Colo. 1967); but see Thomas & Son Transfer Line, Inc. v. Kenyon, Inc., 574 P.2d 107, 112 (Colo. App. 1977) (limiting Aden to contiguous tracts of land for which allocating purchase price would be difficult). The Adens were the lessees of real estate owned by Hathaway. \textit{Aden}, 427 P.2d at 333. The lease contained a clause giving the lessee a right of first refusal. Hathaway also owned a larger tract of land adjacent to the Adens’ lease. Hathaway entered into an agreement with Flank Oil Company to sell both tracts. \textit{Id.} at 333-34. The agreement was conditioned on the Adens releasing and waiving their right of first refusal, which they refused to do. \textit{Id.} at 334. The Adens sought to compel a sale of the leased property to themselves and offered to pay a price based upon the per square foot price from the Flank Oil Company agreement. The trial court refused to order specific performance. \textit{Id.} at 334. The court found that a seller’s willingness to sell a larger tract that includes a burdened property does not indicate a willingness to sell the burdened property by itself.

Gyurkey v. Babler, 651 P.2d 928, 932-33 (Idaho 1982). Western International Investors and Development Company sold a lot in a subdivision, along with a right of first refusal on an adjacent lot, to Gyurkey. \textit{Id.} at 929-30. Western later sold five lots, including the burdened lot, to a third-party. The burdened lot had been listed for $30,000 but was valued in the agreement at $50,000. \textit{Id.} at 930. Gyurkey sued. The trial court ruled against him, finding that the $50,000 allocation was set in good faith. \textit{Id.} at 931. But the court also held that Western could not sell the burdened tract as part of a package transaction, writing “[i]n such a situation as presented here, it is simply impossible for a preemptive right-holder to verify the precise price, not to mention other terms and conditions, at which he is entitled to purchase the property in order to obtain the same bargain on the lot that the third party offeror is to receive. Any separate pricing of lots within the larger tract to be sold can really be nothing more than an allocation of value in relation to the whole rather than an independent offer on the included lot, even if done in good faith, since the true value of the lot rests in its inclusion as part of a larger sale.” \textit{Id.} at 933. The court enjoined Western from selling the burdened lot until it received an acceptable bona fide offer that was unrelated to the sale of any other property. \textit{Id.} at 934.

Myers v. Lovetinsky, 189 N.W.2d 571, 576 (Iowa 1971). Owner leased part of a farm to tenant for a miniature golf course and dairy store. The lease contained a clause allowing tenant to purchase the leased premises at the same
Rights of First Refusal and Package Oil and Gas Transactions

Maryland,\textsuperscript{157} Massachusetts,\textsuperscript{158} New Jersey,\textsuperscript{159} New York,\textsuperscript{160} Nevada,\textsuperscript{161} Ohio,\textsuperscript{162} Oklahoma,\textsuperscript{163} Pennsylvania,\textsuperscript{164} Rhode Island,\textsuperscript{165} South Dakota,\textsuperscript{166} and Wyoming\textsuperscript{167} have held that it does not.

price owner would be willing to sell to a third-party. \textit{Id.} at 573. Owner granted third-party an option to buy the farm for $1,750 per acre, subject to tenant’s lease. Owner also granted tenant a right to purchase the leased property for $20,000. \textit{Id.} at 573. The third-party exercised its option, tenant expressed an interest in exercising its option but objected to the $20,000 purchase price. \textit{Id.} at 574. The court held that Owner breached the preferential right by selling the entire farm and that this was not remedied by the $20,000 allocation. \textit{Id.} at 575. “Upholding such a devise as was attempted here by [Owner] and [third-party] would permit persons occupying those positions to perpetrate wrongs on the tenants. Consider the possibilities. If certain demised premises constituting a half-acre were worth $1,000 and a landlord and a purchaser wanted to eliminate tenant, they could simply provide that the landlord should offer those premises to the tenant for $20,000-although the purchaser was buying the demised premises as part of a larger tract at $1,750 per acre for the whole. The only way the purchaser could eliminate the tenant would be by actually buying or offering to buy the demised premises for a separate price of $20,000.” \textit{Id.} at 575. The court held that the rightholder could not seek specific performance but it could enjoin the sale of its burdened property as part of a larger package. \textit{Id.} at 577.

\textsuperscript{157} Straley v. Osborne, 278 A.2d 64, 69 (Md. 1971) (owner’s intent to sell burdened property as part of a larger transaction does not manifest an intent to sell the burdened property alone).

\textsuperscript{158} Manella v. Brown Co., 537 F.Supp. 1226 (D. Mass. 1982) (rightholder’s preemptive right not invoked by a package transaction including its burdened property but it might be entitled to some form of injunctive relief).

\textsuperscript{159} Guaclides v. Kruse, 170 A.2d 488, 493 (N. J. Super. Ct. App. Div. 1961) (an option of first refusal as to a portion only of a tract may be exercised only if the owner determines to sell that portion for a separate consideration; the attempted sale of the whole tract for a single price is no indication of an intention or desire to sell the portion alone). \textit{See also} Shell Oil Co. v. Trailer & Truck Repair Co., Inc., 828 F.2d 205 (3rd Cir. 1987) (following \textit{Guaclides} and holding that rightholder did not have the right to force the sale to itself of a burdened property included within a package transaction for the consideration allocated to the burdened property in the sale agreement).

\textsuperscript{160} New Atl. Garden v. Atl. Garden Realty Corp., 194 N.Y.S. 34, 40 (App. Div. 1922); \textit{but see} Copalongo v. Giles, 425 N.Y.S.2d 225, 228 (Spec. Term 1980) (holding that a package sale triggers right of first refusal but that entire
package must be offered to the rightholder on the same terms and conditions as the third-party buyer’s offer. See also Johnnies Pelham Road Serv., Inc. v. Thomas, 809 N.Y.S.2d 561, 563 (App. Div. 2006) (because no third-party offered to purchase the leased premises alone, rightholder’s preemptive right of first refusal was never triggered); Sautkulis v. Conklin, 150 N.Y.S.2d 356, 358 (App. Div. 1956) aff’d mem., 141 N.E.2d 916 (1956) (rightholder can exercise preferential right only if owner determined to sell the burdened property separately and not as part of a larger transaction).

Crow-Spieker No. 23v. Robert L. Helms Const. & Dev. Co., 731 P.2d 348, 350 (Nev. 1987) (per curiam). Rightholder purchases tract of land and acquires a right of first refusal on an adjacent tract. Owner decides to sell the burdened property as part of a larger transaction for $10,600 per acre. Id. at 349. Rightholder attempted to exercise its preferential right by purchasing the burdened property alone for $10,600 an acre. Id. at 349-50. The court found that the right of first refusal was not implicated when the owner offered to sell the larger tract. The court concluded that the attempted sale was not an attempt by the owner to evade the rightholder’s rights and that the agreement was made in good faith. Id. at 350. The court also found that the rightholder did not match the terms of the third-party’s offer by refusing to buy the larger tract and that the rightholder had attempted to acquire the burdened tract at less than fair market value. Id. at 350.

Rose Metal Indus., Inc. v. Waters, 579 N.E.2d 767, 771 (Ohio Ct. App. 1990) (owner can only sell burdened property when it receives an offer to buy that tract).

Ollie v. Rainbolt, 669 P.2d 275 (Okla. 1983) (rightholder cannot seek specific performance but can enjoin sale of burdened property as part of a package transaction).


Sawyer v. Firestone, 513 A.2d 36, 40 (R.I. 1986) (a right of first refusal is not invoked when the owner receives an offer for a larger tract of which the burdened property is a part).

Advanced Recycling Sys., LLC v. Se. Props., Ltd. P’ship, 2010 SD 70, ¶18, 787 N.W.2d 778, 785 (S.D. 2010) (rightholder’s preemptive right did not ripen into an enforceable option contract when there was no evidence of an offer to buy just the burdened property).
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These decisions are often premised on the idea that an owner’s intention to sell a burdened property as part of a package does not necessarily indicate an intention to sell the property by itself and that the owner should not be forced to sell property according to terms and conditions to which it did not agree. Some courts also base their decision on concerns about the difficulty involved in properly allocating a portion of the package’s total purchase price to the burdened property.

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167 Chapman v. Mut. Life Ins. Co., 800 P.2d 1147, 1151 (Wyo. 1990) (holding that a preemptive right is not triggered by a package sale “protects the owner from making a sale he did not desire and from problems and potential inequities that may result from deriving value for the smaller burdened tract by allocation, either proportionately … or by some sort of judicial determination of value.”).


169 See Gyrurkey, 651 P.2d at 933 (holding that the parties’ allocation of the purchase price to the properties in a package transaction is not determinative and explaining that “separate pricing of lots within the larger tract to be sold can really be nothing more than an allocation of value in relation to the whole rather than an independent offer on the included lot, even if done in good faith, since the true value of the lot rests in its inclusion as part of a larger sale.”); Guacildes, 170 A.2d at 494 (“In order to apportion, a court would not only have to remake the parties’ agreement, but would also be forced either to indulge in the unwarranted assumption that every acre of the parcel was of equal value, or to engage in the cumbersome and invariably unsatisfactory task of weighing expert testimony on the comparative values of the two parcels.”); see also Thomas & Son Transfer Line, Inc. v. Kenyon, Inc., 574 P.2d 107, 112 (Colo. App. 1977) (distinguishing Aden v. Hathaway’s Estate, 427 P.2d 333, 334 (Colo. 1967), in part by noting that there was no problem in apportioning the purchase price among the properties in the case at hand); Boyd & Mahoney v. Chevron U.S.A., 614 A.2d 1191, 1195 n.1 (Pa. Super. 1992) (holding right of first refusal invoked by package deal and distinguishing L.E. Wallach, Inc. v. Toll, 113 A.2d 258, 261 (Pa. 1955), by noting that
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Other states such as California, Florida, Kansas, Michigan, Missouri, North Dakota, Texas, Vermont, Virginia, and Wisconsin, as well as some federal courts, in L.E. Wallach, there was no basis by which to figure price while in the case at hand the parties had already apportioned the price to the properties).

170 Wilson v. Brown, 55 P.2d 485, 486 (Cal. 1936) (rightholder was entitled to purchase burdened property for its reasonable value when it was sold as part of a larger transaction). See also Park Plaza, Ltd. v. Pietz, 239 Cal.Rptr. 51, 54-55 (Ct. App. 1987) (allocation of sales price to burdened property will be upheld absent evidence of bad faith).

171 Denco v. Belk, 97 So. 2d 261, 263, 265 (Fla. 1957) (rightholder had right to exercise preferential purchase right when owner died and his executor sold several properties, including the burdened property, to a third party).


173 Brenner v. Duncan, 27 N.W.2d 320, 322-23 (Mich. 1947) (preferential purchase right triggered when burdened property sold as part of a larger transaction. Rightholder entitled to specific performance at a price to be determined by using the percentage of the burdened property’s value of the total package times the purchase price).


175 Berry Iverson Co. of N.D., Inc. v. Johnson, 242 N.W.2d 126, 134-46 (N.D. 1976) (specific performance available when burdened tract offered for sale with a larger tract of which it was part at the price per acre set in the purchase agreement with third-party purchaser).

have held that a package sale does trigger the right of first refusal. These decisions seek to protect the seller’s right to convey the burdened property subject to terms and conditions that he is willing to accept while at the same time protecting the rightholder’s ability to exercise its contractual right.\textsuperscript{181}

The next question is what property is subject to the rightholder’s preferential right? Can the rightholder elect or be forced to purchase the entire package or is the right limited to the burdened property? The general rule is that the rightholder’s preferential right burdens only the property described in the document creating the right\textsuperscript{182} and, thus, that it cannot be forced to purchase other property nor can it insist upon the right to purchase the entire package.\textsuperscript{183} The Fourth Circuit explained that the rationale for not requiring the rightholder to purchase the entire package was to prevent the owner from nullifying the right of first refusal by combing the

\begin{itemize}
  \item Field v. Costa, 958 A.2d 1164, 1171 (Vt. 2008) (package deal triggered right of first refusal).
  \item Pantry Pride Enters. v. Stop & Shop Cos., Inc., 806 F.2d 1227, 1230-31 (4\textsuperscript{th} Cir. 1986) (rightholder entitled to purchase real property covered by lease but could not be required to purchase equipment); In re New Era Resorts, LLC, 238 B.R. 381, 387 (Bankr. E.D. Tenn. 1999) (purchase of additional land is a term of the purchase offer that must be met in the exercise of the preemptive right).
\end{itemize}

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  \item\textsuperscript{181} \textit{See Wilber Lime Prods}, 673 N.W.2d at 342.
  \item\textsuperscript{182} Atl. Ref. Co. v. Wyo. Nat’l Bank, 51 A.2d 719, 723 (Pa. 1946) (rightholder’s preferential right to purchase exists by virtue of a contract and, therefore, is defined by that contract).
  \item\textsuperscript{183} \textit{See, e.g.}, Radio WEBS, Inc. v. Tele-Media Corp., 292 S.E.2d 712, 714 (Ga. 1982) (rightholder cannot be forced to purchase properties beyond that burdened by preferential right); Guadilides v. Kruse, 170 A.2d 488 (N.J. Super. Ct. App. Div. 1961) (rightholder of a preferential purchase provision may not obtain specific performance of his option so as to require conveyance to him of the whole property the owner desires to sell).
\end{itemize}
burdened property with other property that the rightholder may not want or cannot afford. Some courts have, however, held that the rightholder must purchase the entire package.

The Eastland Court of Appeals considered whether a rightholder could be forced to purchase the entire package in *McMillan v. Dooley*. The lessee sold three leases to a group including Jimmie McMillan. Each of the leases was burdened by a preferential right to purchase in favor of the original lessees. Only one of the leases, referred to by the parties as the Dooley Lease, had a positive value. McMillan was interested in that lease but the lessee refused to sell it unless McMillan also took two other leases. McMillan relented and he agreed to pay

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184 *Pantry Pride Enters.*, 806 F.2d at 1229.


187 *Id.* at 164. The preferential purchase right provision was identical in all three leases. It provided:

It is further understood and agreed that we, for ourselves, our successors and assigns, reserve a preferential right to purchase the lease to be assigned herein, including any personal property which may be situated thereon. Before you, or your heirs, successors or assigns, shall (1) sell all or any portion of the lease to be assigned herein, (2) plug and abandon any wells on said lease, or (3) finally plug and abandon said lease, you shall first notify us, or our successors or assigns, in writing by registered mail. Such notification shall include the highest bona fide price offered, and we, or our successors or assigns, shall have ten (10) days after receipt of such written notification to purchase for the price offered and receive an assignment, or to reject such offer and allow same to be sold and/or abandoned. If we, or our successors or assigns, fail to act within ten (10) days after receipt of such written notice, then you, your heirs, successors or assigns, shall be free to sell and/or abandon. The above and foregoing preferential option to purchase shall not apply to hypothecation or mortgage of your assets.

188 *Id.* at 165.
approximately $306,000 for an assignment of all three leases. The three rightholders were not advised of the sale.\textsuperscript{189}

Dooley owned the preferential right on the Dooley Lease and, after learning of McMillan’s acquisition, he contacted McMillan and advised him of his preferential purchase right. Prior to then, McMillan was unaware that any of the leases were burdened by a preferential purchase right.\textsuperscript{190} He offered to sell Dooley all three leases for the same price that he had paid and he gave Dooley a copy of his purchase agreement. Dooley, however, refused to purchase anything other than his lease. Thus, no agreement was reached. Dooley and McMillan had some subsequent contact. Dooley persisted in his demand to know how much McMillan had paid for the Dooley Lease. McMillan always replied that it was acquired as part of a package deal and that it had no separate value.\textsuperscript{191}

The parties went approximately two years without any negotiations. Natural gas prices then spiked. Natural gas was selling for $1.50 per MCF when McMillan acquired the three leases. It rose to $9.00 per MCF.\textsuperscript{192} Dooley made a new demand for disclosure of the Dooley lease’s purchase price. His demand was unmet and he filed suit alleging breach of contract, tortious interference, and fraud. He also asked the court to determine a reasonable purchase price for the Dooley Lease.\textsuperscript{193} The rightholders for the other two leases joined the suit and asserted claims seeking to enforce the preferential purchase rights applicable to their leases.\textsuperscript{194}

\textsuperscript{189} \textit{Id.} at 166.

\textsuperscript{190} \textit{Id.}

\textsuperscript{191} \textit{Id.} at 167.

\textsuperscript{192} \textit{Id.} at 168 n. 8.

\textsuperscript{193} \textit{Id.} at 168.

\textsuperscript{194} \textit{Id.} at 168-69.
Dooley argued that McMillan never provided him with an opportunity to exercise his preferential right because he did not segregate the purchase price by lease. The court disagreed. The court found that McMillan complied with Dooley’s contract by providing the material terms of his acquisition when he gave Dooley a copy of the purchase agreement.\textsuperscript{195} Even though McMillan’s purchase agreement included two tracts not covered by Dooley’s preferential right, the court relied upon *Comeaux v. Suderman*,\textsuperscript{196} to hold that McMillan was obligated only to disclose the terms and conditions of his acquisition.\textsuperscript{197}

Dooley had ten days to exercise his option after receiving notice of the McMillan acquisition.\textsuperscript{198} The court held that Dooley was not required to purchase the other two leases and, therefore, that he was not required to accept McMillan’s offer. But the court held that he was required to take some affirmative action within his ten day option period to preserve his preferential right.\textsuperscript{199} As examples of the action Dooley could have taken, the court cited *Texas State Optical, Inc. v. Wiggins*,\textsuperscript{200} and *Riley v. Campeau Homes (Texas), Inc.*\textsuperscript{201} In *Texas State Optical, Inc. v. Wiggins*,\textsuperscript{200} the rightholder had a preferential right to purchase a one acre tract of land. The owner sold that tract along with some adjoining acreage for $350,000. The rightholder was given notice of the sale. He advised the owner that he would not exercise his preferential purchase right because he could not afford to pay $350,000. The rightholder subsequently brought suit and contended that the owner breached the agreement by not giving him the opportunity to purchase only his one acre tract. The court disagreed and found that a sufficient presentment occurred because the owner disclosed the terms of the proposed sale. *Id.* at 219.

\begin{items}
\item \textsuperscript{195} *Id.* at 177.
\item \textsuperscript{196} 93 S.W.3d 215 (Tex. App.—Houston [14\textsuperscript{th} Dist.] 2002, no pet.). In this case the rightholder had a preferential right to purchase a one acre tract of land. The owner sold that tract along with some adjoining acreage for $350,000. The rightholder was given notice of the sale. He advised the owner that he would not exercise his preferential purchase right because he could not afford to pay $350,000. The rightholder subsequently brought suit and contended that the owner breached the agreement by not giving him the opportunity to purchase only his one acre tract. The court disagreed and found that a sufficient presentment occurred because the owner disclosed the terms of the proposed sale. *Id.* at 219.
\item \textsuperscript{197} *Dooley*, 144 S.W.3d at 177-78.
\item \textsuperscript{198} *Id.* at 179.
\item \textsuperscript{199} *Id.* at 180.
\item \textsuperscript{200} 882 S.W.2d 8, 8 (Tex, App.—Houston [1\textsuperscript{st} Dist.] 1994, no writ).
\end{items}
Optical, the rightholder objected to some of the terms of the offer, but it timely notified the owner that, subject to its objection, it intended to exercise its preferential purchase right. It also filed a declaratory judgment action prior to the deadline for accepting the offer.\(^{202}\) In Riley, the rightholders were the tenants of an individual condominium unit. When the owner sold that unit and several other properties, the rightholders demanded that their preferential purchase right be honored and they deposited $5,000.00 in earnest money.\(^{203}\) Because Dooley took no similar affirmative action, the court found that he failed to timely exercise his preferential purchase right.\(^{204}\)

From this case one can draw several general conclusions about Texas law. If an owner is selling a property burdened by a preferential purchase provision as part of a larger package, it must afford the rightholder the opportunity to purchase the burdened property on the same terms and conditions as the third-party purchaser. The rightholder is entitled to notice and at least some information about the transaction. Finally, the rightholder must take some affirmative action before the end of the notice period - even if it is unclear what terms and conditions must be met. Whether the law supports more specific conclusions about these propositions will be explored below.

A. Allocation of Proceeds.

\(^{201}\) 808 S.W.2d 184, 185 (Tex. App.—Houston [14th Dist.] 1991, writ dism’d by agr.).

\(^{202}\) 882 S.W.2d at 10.

\(^{203}\) 808 S.W.2d at 186.

\(^{204}\) Dooley, 144 S.W.2d at 181.
Perhaps the most controversial issue that a package transaction causes when one of the properties is burdened by a preferential purchase price agreement is the allocation of the purchase price to the burdened property. One commentator has noted that the typical preemption clause “provides wholly inadequate guidance on the terms to be met by the holder of the pre-emptive right, particularly with respect to price.”\footnote{Conine, \textit{supra} note 20, at 1321.} Oil and gas properties are not fungible. It would, therefore, ordinarily be a mistake to simply allocate the purchase price pro rata over all of the properties being conveyed.\footnote{\textit{But see} Foster v. Bullard, 554 S.W.2d 66 (Tex. Civ. App.—Austin 1977, writ ref’d n.r.e.) (allocating purchase price pro rata because of the absence of any specific allocation to the burden property in the sales agreement).} Thus, the properties must be individually evaluated. Experts have a number of objective factors to consider when valuing oil and gas properties, particularly well-developed properties. For example, a property’s production history provides considerable guidance because one can see not only how much oil, gas, and water have been produced but the decline curve as well. But oil and gas property evaluation is not an exact science, particularly when the property is not completely developed. In this instance, an appraiser will give consideration to a property’s “upside” that is, the potential for additional reserves if new formations are developed, new recovery methods are used, or secondary recovery operations are implemented.\footnote{\textit{See, e.g.}, Fasken Land & Minerals, Ltd. v. Occidental Permian Ltd., 225 S.W.3d 577, 583 (Tex. App.—El Paso 2005, pet. denied) (purchaser allocated purchase price by considering, in part, a property’s additional potential).} A prospective purchaser will also consider operational costs. If it believes those costs can be lowered, the property may have additional value.\footnote{\textit{See, e.g.}, \textit{id.} at 585 (rightholder believed it could operate the property for less cost than the seller and it adjusted its evaluation upward).} A prospective purchaser
will also consider oil and gas price forecasts. All of this requires the use of opinion and reasonable people can always disagree when opinions are involved.

In addition to these variables, putting several properties together in a package creates the possibility that the whole is greater than the sum of its parts. Or, alternatively, that the seller is grouping particular properties in order to increase the chance of selling a particular property that, on its own, would be unmarketable. In either instance, the total compensation represents considerations that cannot be evaluated simply by looking at the individual properties separately. Finally, because of the composition of a package, it may be worth more to a particular purchaser.

How to allocate a portion of the purchase price to a specific burdened interest presents a difficult issue; and because of the conflicting interests of the rightholder and third-party purchaser, it can be responsible for significant conflict. In fact, partly because of this difficulty, the Idaho Supreme Court found that an owner could not include property burdened by a preferential purchase right in a larger package. The court noted that if a seller were permitted

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209 See, e.g., id.

210 See, e.g., id. at 583 (seller internally discussed values for the burdened property ranging from a low of $40 million to a high of $110 million depending upon the risk weighting of the information).

211 Pantry Pride Enters., Inc. v. Stop & Shop Cos., Inc., 806 F.2d 1227, 1230 (4th Cir. 1986) (recognizing that the seller may be receiving a premium by selling several properties together).

212 See, e.g., McMillan v. Dooley, 144 S.W.3d, 159165 (Tex. App.—Eastland 2004, no pet.) (package included three leases – only one of which had a positive value).

213 See, e.g., In re Adelphia Comm’ns Corp., 368 B.R. 348, 356-58 (S.D.N.Y. 2007) (cable franchises were worth more to Time Warner than other potential buyers because of synergies and economies of scale that it could bring to bear).

to allocate a portion of the purchase price to the burdened property, “even if done in good faith, not only would the preemptor be denied assurance that he was obtaining the same bargain on the lot as was the third party offeror, but the door would be opened to a myriad of unscrupulous endeavors designed to defeat preemptive rights by manipulation of lot prices within terms of a larger sale.”\textsuperscript{215} Conversely, a California court recognized the possibility of abuse in the allocation process but because actual abuse can be adjudicated and defused, it found that categorically rejecting the parties an opportunity to allocate the purchase price was akin to throwing the baby out with the bathwater.\textsuperscript{216}

1. Who Allocates?

Determining who is responsible for the allocation of the purchase price in a package transaction will depend on a number of factors including the nature of the deal. For example, if the transaction involves the acquisition of one company’s entire assets, it will normally be the purchaser.\textsuperscript{217} In this instance, the goal is not necessarily determining the fair market value of individual properties on a stand-alone basis because the allocation values must equal the total purchase price. If the buyer is paying a premium or is receiving a discount, the allocation will necessarily depart from a true fair market valuation. But, the allocation cannot totally disregard fair market valuations. The purchaser must allocate the purchase price proportionately among

\textsuperscript{215} Id.

\textsuperscript{216} Park Plaza, Ltd. v. Pietz, , 239 Cal. Rptr. 51, 55 (Ct. App. 1987).

\textsuperscript{217} See, e.g., Fasken Land & Minerals, Ltd. v. Occidental Permian Ltd., 225 S.W.3d 577, 582 (Tex. App.—El Paso 2005, pet. denied)(buyer allocates the purchase price because “they know what they were paying for it.”).
the assets according to their relative fair market values at the time of the acquisition to establish their cost basis for tax purposes.\textsuperscript{218}

This is not to say that the seller has no role in a total asset sale. The seller wants to receive as high a purchase price as possible and, therefore, while marketing its assets has an incentive to not only promote a property’s current economics but its potential as well. In this regard, the seller will supply information supporting a high valuation.\textsuperscript{219} As will be discussed in more detail in the litigation section of this paper, that information may be discoverable, and in any event much focus will be given to the allocation process. Depending upon the facts, information provided to potential buyers by the seller or input on allocation values given by the seller could be key to either side’s case. Regardless, at the end of the negotiations, the seller will sign the purchase and sale agreement and, thus, will be signing off on the allocation values. It is, therefore, not unheard of for the seller to have some input.\textsuperscript{220}

In other situations, the nature of the deal may cause the seller to become more involved in the allocation process. For example, if the third-party purchase agreement includes a due diligence review period and allows the purchaser to exclude properties with environmental or

\textsuperscript{218} 26 U.S.C.A. § 1012. C.D. Johnson Lumber Co. v. C.I.R., 12 T.C. 348, 363 (1949). \textit{See also} 26 CFR 1.61-6 (when buying several properties for a lump sum, the purchaser equitably apportions the costs to the different properties). Assuming this is an asset sale and not a stock sale, the owner would employ a similar procedure to determine gain or loss on the disposition of each asset under 26 U.S.C.A. §§ 61, 1001. In some instances, stock purchases can be treated as asset acquisitions for basis determinations. \textit{See} 26 U.S.C.A. § 1060.

\textsuperscript{219} \textit{See, e.g.}, \textit{Fasken}, 225 S.W.3d at 582 n. 5 (seller retained an independent engineering firm to value its properties and provided bidders with a significant amount of information on those properties).

\textsuperscript{220} \textit{See, e.g.}, \textit{id.} at 583-84 n. 8 (seller reviewed buyer’s allocations for a reasonableness check and agreed to its allocation for the burdened property).
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title issues, the seller would have an incentive to review the buyer’s allocations for possible over-
evaluations. The seller wants to protect as much of the total purchase price as possible. If the
seller believes a property is overvalued, this creates the risk that it could suffer
disproportionately if that property is later excluded from the transaction because of information
discovered during the due diligence period.

2. How Do You Allocate Consideration Per Asset?

The allocation of the purchase price over the individual assets need not necessarily reflect
a fair market valuation for each property because the purchase price reflects the value of the
package not the sum of the values of the individual properties. It is important to recognize that
the ultimate allocation will necessarily reflect subjective judgments by the third-party purchaser;
and that if the rightholder has a terms and conditions based preferential right, the rightholder is
ultimately subject to the purchaser’s judgment. Objective, historical information is significant
when evaluating oil and gas properties but what the purchaser believes the property can produce
in the future is ultimately determinative.221 Assume a particular tract is nearing the end of its
economic life based upon current production and cost numbers. If the buyer believes that new
formations can be developed or that secondary recovery operations are possible, it would be
entirely appropriate for the buyer to use a higher allocation than someone (such as the seller or
rightholder) who disagrees about the potential of secondary recovery operations or the viability
of new formations.

221 See, e.g., id. at 582 (purchaser’s allocation included its assessment of reserves beyond the proved developed
reserves).
When a buyer is acquiring all of a company’s assets, it may also be required to assume liabilities.\textsuperscript{222} If the liabilities are liquidated, the allocation process will simply reflect this number as part of the consideration paid. If they are unliquidated, the buyer must assign a value to its contingent liability and then include this in the purchase price. That process can become even more difficult if, for example, the contingencies include pending litigation. The buyer should assume that its evaluation will become public or at least known to the adversaries in the litigation. A buyer hoping to settle a lawsuit for $1 million will be at a serious negotiating disadvantage if the other side learns that it assigned the litigation a $2 million value in the purchase and sale agreement.

When the purchase price includes assuming unliquidated liabilities, the potential for conflict between the purchaser and rightholder is accentuated. The conflict can be caused by ill motive but it can also simply reflect two different perspectives. The rightholder is concerned only about its preferential right, and when it sees a valuation that it believes does not reflect fair market value, it is easy to conclude that the purchaser is simply trying to defeat its preferential right. To the purchaser, however, contingent liabilities are a serious concern. Psychologically it is understandable that a company will plan for the worst and hope for the best and, therefore, will take a conservative approach. But the higher it values the contingent liability, the higher its allocation will be on an individual property.


\textsuperscript{222} See, e.g., McMillan v. Dooley, 144 S.W.3d 159, 167 (Tex. App.—Eastland 2004, pet. denied)(purchaser paid $306,543 and assumed unliquidated liabilities to acquire three oil and gas leases).
Unlike purchase price determinations - which are necessarily prospective and build upon asset valuations, allocations are retrospective and deconstructive. The individuals responsible for the allocation know the total purchase price and the assets being conveyed. The sum of the parts must equal the whole. No more. No less. When two parties are negotiating the sale of a single asset, their competing interests provide some assurance that the purchase price represents a fair evaluation of the asset’s worth. Those same conflicting interests, however, may or may not be present during the allocation process. Furthermore, the rightholder’s shadow interjects a new dynamic: third-party control. Until the end of the notice period, the purchaser and seller must wait for the rightholder to make a decision before they know what assets will be included in their agreement. Because the allocation may well determine whether the rightholder exercises its preferential right, the purchaser has an incentive to inflate the allocation to discourage this exercise or to deflate the allocation if it wishes to encourage its exercise. The Fourth Circuit has noted that “allocation of price to elements of a package may readily be manipulated to defeat contractual rights of first refusal. It is easy to imagine an unreasonably inflated value assigned to the subject of any first-refusal option.”223 The rightholder’s incentive is to see as low an allocation as possible if it desires to exercise its preferential right. In the normal course of negotiations, there may be some discussion between the purchaser and rightholder even if this discussion is prompted by a rightholder that does not want to purchase the property but simply wants to encourage the purchaser to pay for a waiver.

Courts have employed various guidelines to evaluate allocations and these guidelines will be examined below but initially, it is critically important to recognize that the sales agreement should document that portion of the sales price being allocated to the burdened property. In

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223 Pantry Pride Enters., Inc. v. Stop & Shop Cos., Inc., 806 F.2s 1227, 1231-32 (4th Cir. 1986).
Foster v. Bullard, there was no such allocation and the court applied a pro rata distribution that arguably allowed the rightholder to acquire the burdened property at a fraction of its fair market value.\textsuperscript{224} In 1967, Foster purchased thirty acres from Bullard out of the Casa Monte Ranch. The parties agreed that Foster would have a right of first refusal to buy at a price consistent with other offers but not less than $750 per acre, an additional tract of approximately fifty acres.\textsuperscript{225} Bullard received an offer from Hendrix to buy the entire Ranch (approximately 2,460 acres) for $1.6 million. Bullard informed Hendrix that Foster’s preferential right burdened 164 acres. Hendrix believed the burdened property was worth $3,500 per acre. The sales agreement recited a total consideration of $1.6 million and it allocated $492,800 to the burdened 164 acres.\textsuperscript{226} Bullard notified Foster of the proposed sale, advised him that the 164 acres was being sold for $3,000 per acre, and offered the tract to him at that price. Before closing, Hendrix assigned his purchase rights to Mutual Savings. It renegotiated the purchase agreement with Bullard. The new agreement did not allocate any portion of the purchase price to the 164 acres. It simply reflected that the entire ranch was being sold for $1.6 million.

Foster sued for specific performance of his preferential purchase right. He contended that the sale to Mutual Savings was made on a per-acre basis for $650 per acre. The Austin Court of Appeals agreed. Hendrix allocated a specific portion of the purchase price to the burdened acreage in his contract but the court found that the controlling price and terms were contained in the subsequent contract between Mutual Savings and Bullard. That contract provided no basis for segregating the burdened tract from the balance of the ranch and no instrument provided any

\textsuperscript{224} 554 S.W.2d 66 (Tex. Civ. App.—Austin 1977, writ ref’d n.r.e.).

\textsuperscript{225} Id. at 67.

\textsuperscript{226} Id.
basis for a distinction in the sales price for different portions of the ranch.\textsuperscript{227} The court, thus, calculated the average per-acre sales price for the entire ranch. This was $650 per acre. Because Foster’s preferential right contained a floor price of $750 per acre, the court held that he was entitled to buy the burdened property for $750 per acre.\textsuperscript{228}

If Hendrix’s valuation of $3,500 per acre for the burdened property is correct, then the result was inequitable because Foster paid 25\% or less of the consideration the parties agreed upon in their sales agreement. The opinion does not say why the revised contract contained no allocation price for the burdened property. Based upon the facts, it appears more likely that when Mutual Savings renegotiated the transaction someone forgot to include an allocation price than it does that Mutual Savings disagreed with Hendrix’s evaluation and believed that the ranch could be fairly evaluated on a pro rata basis. The result can, however, be supported on traditional contract interpretation principles. Unless a contract is ambiguous, courts are instructed to determine the meaning of the language used by the parties and not to determine what the parties meant to say.\textsuperscript{229} The court could not determine that Mutual Savings intended a different allocation for the burdened property than the rest of the ranch without considering parole evidence. Not only is that against general contract interpretation principles, it would unfairly allow valuation testimony after the agreement has been consummated and there are no longer arms-length negotiations between the buyer and seller. This is disconcerting for a court because when the limiting influence of competing interests is diminished, what remains is a buyer who is motivated to discourage the exercise of the preferential right and, therefore, it

\textsuperscript{227} Id. at 71.

\textsuperscript{228} Id.

\textsuperscript{229} Alford v. Krum, 671 S.W.2d 870 (Tex. 1984) (the question is not what did the parties meant to say, but the meaning of what they did say).
affords less confidence that the proffered allocation fairly represents what the buyer paid for the burdened property. Finally, the lack of an allocation price is a problem easily remedied by the buyer.

Many courts have imposed equitable concepts upon the allocation process and have held that the burdened property’s allocation cannot be “padded” to prevent the rightholder from exercising its preferential purchase right. To determine if an allocation was padded, courts have looked at the allocation process and asked if it represented a bona fide offer or if the allocation was done in good faith. In such a case, evidence that the allocation was made based upon an engineering study, historical production, or other objective, trustworthy factors would be persuasive. For example, in In re Adelphia, the court affirmed an allocation process for the sale of cable franchises based upon the number of subscribers.

Because allocations can have tax consequences – the recognition of a taxable gain or loss for the seller and a basis for the purchaser, the purchaser or owner may argue that tax considerations supply a measure of protection for rightholders because this gives both parties an

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230 See, e.g., Navasota Res., L.P. v. First Source Tex., Inc., 249 S.W.3d 526, 542-43 (Tex. App.—Waco 2008, pet denied) (seller should be held to the allocated price absent affirmative evidence of bad faith or some improper basis for the allocated price). See also Pantry Pride Enters., Inc. v. Stop & Shop Cos., Inc., 806 F.2s 1227, 1231-32 (4th Cir. 1986) (price allocated must be viewed with skepticism as elements of package may be manipulated to defeat contractual rights of first refusal).


233 Adelphia, 368 F.2d at 349-50, 356.
incentive to correctly allocate the purchase price. The parties, however, need not necessarily use the contract’s allocation for tax basis purposes or, for that matter, both use the same basis.\textsuperscript{234}

In \textit{Pantry Pride Enterprises, Inc. v. Stop & Shop Companies, Inc.},\textsuperscript{235} the court looked at the inverse of this principle and held that the rightholder was not entitled to exercise its preferential right by paying the allocated consideration because that number reflected tax

\textsuperscript{234} If the purchaser is buying all of the stock of the selling corporation, the default rule is that the target corporation’s pre-acquisition basis in its assets remains the same in the acquirer’s hands after a stock purchase changing ownership, however, a purchasing corporation may elect to treat a qualified stock purchase as an acquisition of the target corporation’s assets. 26 U.S.C.A. § 338(a). A qualified stock purchase means a transaction or series of transactions in which stock having at least 80 percent of the total voting power and at least 80 percent of the total value of the stock of one corporation is acquired by another corporation during the twelve-month acquisition period. 26 U.S.C.A. §§ 338(d)(3), 1504(a)(2). If there is an election, the target corporation shall be treated as having sold all of its assets at the close of the acquisition date at fair market value in a single transaction and shall be treated as a new corporation which purchased all of these assets as of the beginning of the day after acquisition. 26 U.S.C.A. § 338(a)(1). The assets will be treated as purchased for an amount equal to the grossed-up basis of the purchasing corporation’s recently purchased stock in the target and the basis of the purchasing corporation’s non-recently purchased stock. 26 U.S.C.A. § 338(b)(1). Grossed-up basis is the amount equal to the basis of the corporation’s recently purchased stock, multiplied by a fraction with the numerator being the percentage of stock by value in the target corporation attributable to the purchasing corporation’s non-recently purchase stock and the denominator is the percentage of stock by value in the target corporation attributable to the purchasing corporation’s recently purchased stock. 26 U.S.C.A. § 338(b)(4). Recently purchased stock is any stock in the target held by the purchasing corporation on the acquisition date and purchased by the corporation during the 12 month acquisition period. 26 U.S.C.A. § 338(b)(6). The amount treated as the purchase price for the target’s assets would then be allocated among the assets in order to determine gain or loss on the sale of each asset that the old target will have to recognize and the new target’s basis in each of the assets. 26 U.S.C.A. § 338(b)(5); 26 C.F.R. §§ 1.338-4(e), 1.338-6.

\textsuperscript{235} 806 F.2d 1227 (4th Cir. 1986).
Rights of First Refusal and Package Oil and Gas Transactions

planning. Pantry Pride leased a portion of a shopping center to Stop & Shop subject to a right of first refusal. Pantry Pride then sold the shopping center, along with other shopping centers, to Richmond. 75% of the purchase price was allocated to equipment and 25% to the leases. $571,000 was allocated to the Stop & Shop property. $482,250 of this was for equipment and $142,750 for the lease. Stop & Shop attempted to exercise its preferential right at $142,750. Pantry Pride rejected this offer, contending that Stop & Shop was required to purchase both the lease and equipment. The court held that the preferential right applied only to the property and, therefore, that Stop & Shop could not be required to purchase the equipment. But, the court held that Stop & Shop was not entitled to specific performance on the allocated lease price because that value was made for tax purposes and, therefore, did not necessarily reflect the lease’s real worth. The court remanded the case to the trial court with instructions to consider the value of the entire shopping center at the time of the offer and the percentage of value fairly attributable to the lease. That percentage would, then, be applied to the $571,000 allocated to the shopping center.

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236 Id. at 1228.
237 Id.
238 Id. at 1229 (seller cannot force an option holder to buy more property than covered by preferential purchase provision because otherwise “Pantry Pride could effectively nullify the right of first refusal by combining the lease with items that Stop & Shop may not want or cannot afford.”).
239 806 F.2d at 1231. See also Tenneco Inc. v. Enter. Prods. Co., 925 S.W.2d 640, 645 (Tex. 1996) (“State law, not the Internal Revenue Code, controls the transactions characterization. How the parties portray their transaction for federal tax purposes is immaterial.”).
240 Pantry Pride Enters.,806 F.2d at 1232.
Fair market valuations are attractive to courts because they are so often used in other contexts, such as dividing assets in a divorce and, therefore, courts are familiar with the methodology. They are also attractive because they portend to eschew subjective factors in favor of objective analysis. But while fair market valuations are relevant, they are not determinative. One would normally expect the valuation of a burdened property to have some relationship to its fair market value as a stand-alone property. Thus, courts can use them as a means of testing the trustworthiness of the allocation process.\(^{241}\) But fair market valuations are not determinative because the rightholder has only the right to buy on the same terms and conditions as a third party. If the third party is paying a premium for the package, the rightholder may properly be required to pay a premium as well. On the other hand, if the court determines that the burden property’s allocation was padded, the rightholder has been entitled to a fair market valuation of the burdened property.\(^{242}\)

B. Notice

The owner’s duty to provide notice of a third-party offer is initially defined by the contract provision creating the preferential right. Generally, the owner must provide the

\(^{241}\) See Uno Rests., Inc. v. Boston Kenmore Realty Corp., 805 N.E.2d 957, 962-64 (Mass. 2004) (rightholder offered evidence that burdened property was allocated a price above its fair market value but court noted that it offered no evidence that nonburdened property was allocated prices lower than their fair market value).

\(^{242}\) See In re Adelphia Commc’ns Corp., 368 B.R. 348, 356-57 (S.D.N.Y. 2007) (fair market valuation not required when buyer and seller have allocated a good faith price to the property).
information and in the manner required by the contract. However, substantial performance is normally sufficient. If the contract does not specify the manner or means of providing notice, courts have held that any method that gives the rightholder notice of the potential sale and that reasonably discloses the terms and conditions of the sale is sufficient to trigger the preferential right. Disclosure is reasonable if the notice provides the rightholder with sufficient information about exercising its preferential right. This requires disclosure of the offer’s material terms and conditions. As the Houston Court of Appeals noted in Edmunds v. Houston Lighting & Power Co., the notice should be so definite in its terms and

243 See Fasken Land & Minerals, Ltd. v. Occidental Permian Ltd., 225 S.W.3d 577, 590 (Tex. App.—El Paso 2005, pet. denied) (owner’s obligation to provide notice was defined by the terms of the preferential purchase right provision.

244 Ellis v. Waldrop, 656 S.W.2d 902, 904 (Tex. 1983) (affirming a jury finding that the owner substantially performed its requirement to provide the rightholder with notice); Fasken, 225 S.W.3d at 591 (notice was sufficient to reasonably disclose the proposed transaction even if there were technical deficiencies that rendered that notice less than perfect); Comeaux v. Suderman, 93 S.W.3d 215, 221 (Tex. App.—Houston [14th Dist.] 2002, no pet.) (even though notice was not a model of clarity, it reasonably disclosed owner’s intention to sell the leased premises and additional property to a third party).

245 See e.g., Koch Indus., Inc. v. Sun Co., 918 F.2d 1203, 1212 (5th Cir. 1990) (applying Texas law).

246 See id. at 1212. See also Gyurkey v. Babler, 651 P.2d 928, 931 (Idaho 1982) (owner must convey the entire offer to the rightholder in such a form as to enable him to evaluate it and make a decision).

247 Roeland v. Trucano, 214 P.3d 343, 348 n. 11 (Alaska 2009) (“[A]ll terms and entire offer must be communicated but copy of offer ordinarily sufficient so long as it contains full agreement between seller and third party.”).

248 472 S.W.2d 797 (Tex. Civ. App.—Houston [14th Dist.] 1971, writ ref’d n.r.e.).
comprehensive in its coverage of the essential, that a “yes” from the rightholder creates a completed and definite agreement.\textsuperscript{249}

The owner cannot rely upon the rightholder’s constructive notice.\textsuperscript{250} For example, courts have rejected the argument that the rightholder’s claim was barred because he should have read newspaper accounts about the burdened property’s sale.\textsuperscript{251} Courts have, however, considered additional information provided by the owner subsequent to the notice letter to determine the sufficiency of the owner’s disclosure.\textsuperscript{252} If the owner fails to provide notice, or if it provides insufficient notice, a preferential right is not triggered.\textsuperscript{253}

In a package transaction, the duty to provide notice presents a challenge for the owner because it cannot simply copy and forward the sales agreement. Instead, it must distill that portion of the offer intended for the burdened property. Hopefully, the parties have allocated a

\textsuperscript{249} Id. at 798-99. This case did not involve a preferential purchase provision but, instead, concerned a dispute over a circular or brochure. The question before the court was whether the brochure was an offer to enter into a contract. Because the notice letter matures a dormant option into a binding option, the court’s analysis of what is necessary to constitute an offer is applicable.

\textsuperscript{250} See Mandell v. Mandell, 214 S.W.3d 682, 688 (Tex. App.—Houston [14\textsuperscript{th} Dist.] 2007, no pet.) (rejecting owner’s argument that because the rightholder knew about a contingent-fee contract giving the owner’s attorney a percentage of any recovery in a lawsuit against the rightholder it was notice that the burdened property would be transferred to the attorney in satisfaction of the contingent-fee contract).


\textsuperscript{252} Mecom v. Gallagher, 213 S.W.2d 304, 306 (Tex. Civ. App.—El Paso 1947, no writ) (noting rightholder met with owner and third-party purchaser where the “whole matter of the sale was discussed.”).

\textsuperscript{253} McMillan v. Dooley, 144 S.W.3d 159, 174 (Tex. App.—Eastland 2004, pet. denied) (“[t]he rightholder does not have a duty to act in order to exercise his preferential purchase right unless and until he receives a reasonable disclosure of the terms of the contemplated conveyance.”).
portion of the purchase price to the burdened property and the third party realizes that the rightholder can purchase the property for that allocated sum. When the rightholder receives notice of the proposed sale, it then has the duty to undertake a reasonable investigation of any unclear terms.\(^{254}\) Logically, it is reasonable to expect that the rightholder will have questions about the allocation process, especially if it suspects an attempt to defeat its preferential right. If the contract defines the information the owner must provide, Texas courts have held that the owner need not go beyond the contract’s requirements.\(^{255}\) In that situation, the owner would not be required to answer questions about the allocation. But if the owner is confident that the allocated price is reasonable, responding to the rightholder’s questions might well prevent subsequent litigation.

Once the owner has made a reasonable disclosure of an offer, the rightholder has a duty to investigate all terms of the offer that are unclear.\(^{256}\) A disclosure is sufficient even though the offer includes property not covered by the preferential purchase right.\(^{257}\) In *Comeaux v. Suderman*,\(^{258}\) less than an acre on Bolivar Peninsula was leased to Comeaux subject to a right of first refusal on the same terms and conditions as a prospective buyer. Suderman received an

\(^{254}\) *Koch Indus., Inc. v. Sun Co.*, 918 F.2d 1203, 1212 (5th Cir. 1990) (rightholder must actually and formerly seek clarification of any ambiguous terms in the third-party offer).


\(^{258}\) *Dooley*, 144 S.W.3d at 178.

\(^{258}\) 93 S.W.3d 215 (Tex. App.—Houston [14th Dist.] 2002, no pet.).
offer to buy the leased premises along with adjoining property for $350,000, and he provided notice of this offer to Comeaux. While Comeaux contacted Suderman’s attorney about the deal, he did not inquire into the specific terms of the sale or whether he could purchase only the leased premises. Comeaux subsequently refused to exercise his right. The court held that Suderman’s notice to Comeaux reasonably disclosed Suderman’s intention to sell the leased premises and adjoining property to a third party for $350,000. At this point, Comeaux had a duty to undertake a reasonable investigation of any terms that were unclear to him and he could not later complain that he did not have sufficient information to make an informed choice about purchasing the property subject to the right of first refusal.

A reasonable investigation on the part of the rightholder means that the rightholder must make an actual request for information. In *Koch Industries, Inc. v. Sun Co., Inc.*, the rightholder sent letters to the seller objecting to the offer as vague or ambiguous. The Fifth Circuit held that this was not a reasonable investigation because it did not actually request information concerning the terms that the seller considered to be vague and ambiguous.

Besides the difficulty of allocating a portion of the proceeds to the burdened property, package transactions potentially impose upon the owner or third-party purchaser the risk of being bound by an offer that does not ultimately represent the terms of their agreement. For example, assume owner and purchaser have entered into an agreement and have allocated $100,000 to the

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259 *Id.* at 217.
260 *Id.* at 218.
261 *Id.* at 221.
262 *Koch Indus., Inc. v. Sun Co.*, 918 F.2d 1203, 1213 (5th Cir. 1990).
263 918 F.2d 1203 (5th Cir. 1990).
264 *Id.* at 1213.
burdened property, an oil and gas lease. Notice is sent to the rightholder informing it that it can purchase the lease for $100,000 for the next thirty days. Prior to the end of that period, and before the rightholder has made an election, the allocations are revisited (for a good faith reason). The burdened property’s allocation is revised to $250,000 but the total purchase price remains unchanged. Can owner revoke the $100,000 offer and send a revised notice giving the rightholder the opportunity to purchase the lease for $250,000?

_Henderson v. Nitschke_,\(^{265}\) suggests that the answer may be no. In this case, the owner received an offer from a third party to purchase a lease and, as required by the lease, gave the lessee the opportunity to match that offer for 60 days.\(^{266}\) Prior to the end of the 60 days and before lessee made any election, the third party revoked its offer. The owner informed the lessee of this and revoked its offer. The lessee then gave notice of its intent to purchase the lease on the same terms as previously offered by the third party.\(^{267}\) The court held that when the owner sent notice of the proposed sale, the lessee’s preferential right matured into an enforceable option and that it had 60 days to decide whether to accept it or not.\(^{268}\)

Conversely, in _Holland v. Fleming_, the court held that a preferential right to purchase did not create an option that survived the termination of the sales agreement.\(^{269}\) The owner agreed to sell a piece of property burdened by a right of first refusal. Before notice was given to the

\(^{265}\) 470 S.W.2d 410 (Tex. Civ. App.--Eastland 1971, writ ref’d n.r.e.).

\(^{266}\) _Id._ at 411.

\(^{267}\) _Id._

\(^{268}\) _Id._ at 414. _See also_ City of Brownsville v. Golden Spread Elec. Coop., 192 S.W.3d 876, 880 (Tex. App.—Dallas 2006, pet. denied) (after owner gives the rightholder notice of his intent to sell, the terms of the option cannot be changed for as long as the option is binding on the property owner).

\(^{269}\) 728 S.W.2d 820 (Tex. App.—Houston [1st Dist.] 1987, writ ref’d n.r.e.).
rightholder, the agreement was terminated by mutual agreement.\textsuperscript{270} The rightholder contended that his right of first refusal became an option when the sales agreement was signed.\textsuperscript{271} The court disagreed. It found that when the sales agreement was executed, the owner had a reasonable amount of time to notify the rightholder of the terms of the proposed sale. When the parties terminated the sales agreement, the owner no longer had a duty to notify the rightholder and, therefore, the rightholder’s preemptive right of purchase never matured into an enforceable option.\textsuperscript{272}

The two cases can be reconciled by focusing on the notice letter. When the owner agrees to sell its property, it has a duty to provide notice within a reasonable amount of time. When it does so, the rightholder’s dormant option becomes an enforceable option. But during the interim between the owner entering into a sales agreement with a third party and providing notice to the rightholder, the option does not mature. Because it has not, the owner retains the discretion to void that agreement without violating a duty to the rightholder. The limitation to this reconciliation is the assumption that the seller has not improperly delayed providing notice. Unless the owner terminates the agreement fairly quickly, it faces an argument from the rightholder that breached the agreement by not timely providing notice and that because it had entered into an agreement to sell the burdened property, its preferential right was triggered.

C. Acceptance

\textsuperscript{270} \textit{Holland}, 728 S.W.2d at 821.

\textsuperscript{271} \textit{Id.} at 821, 823.

\textsuperscript{272} \textit{Id.} at 823.
The general rule is that the rightholder must exercise its option by unambiguously agreeing to all the terms and conditions of a third party’s bona fide offer. That is, or at least may be, problematic in a package transaction because the rightholder’s option covers only one piece of the package and, therefore, it does not have the contractual right to agree to all of the terms and conditions of that offer nor can it be forced to do so. *Mcmillan v. Dooley*, provides an interesting framework for consideration of a rightholder’s position in a package transaction. Recall that Dooley had a preferential right to purchase a lease that was included within a package transaction. Despite repeated requests, the purchaser refused to place a specific dollar figure on the purchase price of the burdened lease but, instead, insisted that the package was nonseverable. The court held that Dooley had the right to purchase his lease and that he was not required to purchase the entire package of properties. However, even though the purchaser never gave him the opportunity to purchase just his lease, the court found that Dooley received a sufficient

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273 *Navasota Res.*, 249 S.W.3d at 533. *See also Town of Lindsay v. Cooke County Elec. Coop Ass’n*, 502 S.W.2d 117, 118 (Tex. 1973) (when an offer prescribes the time and manner of acceptance, its terms must be complied with to create a contract).


275 *Dooley*, 144 S.W.3d at 178. *See also Hinds v. Madison*, 424 S.W.2d 61, 64 (Tex. Civ. App.—San Antonio 1968, writ ref’d n.r.e.) (“We do not see how in any way lessee’s option or preference right to purchase a portion of the property sought to be sold can be enlarged to cover other lands owned by lessors, or can in any manner cover anything except the property actually subject to the option.”); *Pantry Pride Enters., Inc. v. Stop & Shop Cos., Inc.*, 806 F.2d 1227, 1229 (4th Cir. 1986) (seller cannot force an option holder to buy more property than covered by the first refusal provision).
presentment when McMillan provided him with the terms and conditions of his acquisition and, therefore, that Dooley’s preferential right matured into an enforceable option.\textsuperscript{276}

How, then, does one accept an offer that was never made? To complicate this, remember that the exercise of an option is equivalent to the acceptance of an offer under contract law.\textsuperscript{277} If the optionee changes or qualifies the terms of an offer, the offer is considered rejected.\textsuperscript{278} Similarly, if the optionee’s purported acceptance contains a new demand, proposal, condition, or modification of the terms of the offer it is ordinarily rejected.\textsuperscript{279} If the rightholder orally indicates it is uninterested in exercising its right to purchase, the offer may be considered rejected.\textsuperscript{280} Finally, consider also that whatever the action rightholder takes must be done within the time provided to accept the offer.\textsuperscript{281} Otherwise, the failure to act will be considered a rejection of the offer.\textsuperscript{282}

\begin{footnotesize}
\begin{enumerate}
\item[276] 144 S.W.3d at 178. The court relied upon \textit{Hinds,}, 424 S.W.2d 61, for this proposition. In that case, the rightholder had a preferential right to purchase a portion of a ranch. The owner entered into an agreement to sell the entire ranch and the rightholder asserted the right to match that offer. The court rejected this argument and held that he had no right to purchase anything other than his burdened tract. \textit{Id.} at 64. The Eastland Court concluded that if a rightholder could not use his preferential right to purchase additional property, he could not be required to do so either. \textit{Dooley}, 144 S.W.3d at 179.
\item[277] Texas State Optical, Inc. v. Wiggins, 882 S.W.2d 8, 10-11 (Tex. App.—Houston [1st Dist.] 1994, no writ).
\item[278] \textit{Id.}
\item[279] \textit{Id.}
\item[281] A.G.E., Inc. v. Buford, 105 S.W.3d 667, 673 (Tex. App.—Austin 2003, pet. denied)(the presentment of a contemplated conveyance to the rightholder triggers a duty to act within the time period specified in the preferential purchase provision).
\item[282] Comeaux v. Suderman, 93 S.W.3d 215, 220 (Tex. App.—Houston [14th Dist.] 2002, no pet.).
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In *McMillan*, the court held that the rightholder must at least take some affirmative action during the option period.\(^{283}\) As an example of the action Dooley could have taken, the court pointed to *Riley v. Campeau Homes*,\(^{284}\) where the rightholder had a preferential right to purchase a condominium unit. In response to a package sale that included this condominium, the rightholder demanded that its preferential right be honored and it made an earnest money deposit.\(^{285}\) Had Dooley taken a similar approach, presumably he would have at a minimum affirmatively expressed his intent to purchase the Dooley Lease. Because his preferential right matured into an enforceable option when that lease was conveyed to McMillan, this expression could be construed as creating a binding contract.\(^{286}\) If he completely followed the *Riley* example he would have also tendered an earnest money deposit. However, even if Dooley simply expressed his desire to purchase the Dooley Lease, he would have incurred the risk of being committed to purchase the Lease before he knew its cost.

There may be times when the rightholder wants the property regardless of its cost but most often the rightholder’s decision whether to exercise its option is dependent upon the cost of that option. Arguably, this is reflected in the typical terms and conditions provision. The right to purchase on the same terms and conditions offered by a third party strongly suggests that the rightholder will know what its obligation will be before committing itself to a binding agreement. Moreover, the notion that a rightholder can be contractually bound to purchase a


\(^{284}\) 808 S.W.2d 184 (Tex. App.—Houston [14th Dist.] 1991, writ dism’d by agr.).

\(^{285}\) *Id.* at 186.

\(^{286}\) *But cf. Abraham Inv. Co. v. Payne Ranch, Inc.*, 968 S.W.2d 518, 525 (Tex. App.—Amarillo 1998, pet. denied) (oral statement of intent to accept offer was insufficient because the terms of the offer required a written response).
piece of property before knowing its cost seems counter to the principle that a binding contract requires a meeting of the minds.287

The Eastland Court also pointed to *Texas State Optical*,288 for an example of affirmative action. This was not a package conveyance but the court considered it instructive nonetheless. In this case, the rightholder objected to some of the terms but, prior to the end of the offer period, it notified the property owner that it intended to exercise its preferential right subject to its objection and it filed a declaratory judgment action.289 This approach may minimize the rightholder’s risk because the presence of an objection presents an opportunity to avoid a binding contract if the purchase price is undesirable. But there is no guarantee that the purchase price will be determined before the objection is resolved or that the objection will be considered meritorious.

Another option for the rightholder is illustrated by *Fasken Land and Minerals, Ltd. v. Occidental Permian Ltd.*290 Fasken owned working interests in the Midland Farms Unit (MFU) and it had a preferential right to purchase other working interest in that Unit.291 Altura Energy

287 See David J. Sacks, P.C. v. Haden, 266 S.W.3d 447, 450 (Tex. 2008) (a meeting of the minds is necessary to form a binding contract).


289 Id. at 10-11.


291 The preferential right was contained within a Unit Operating Agreement. It provided:

*Preferential Right to Purchase.* Should any party hereto desire to sell or otherwise assign, transfer or dispose of its interest in the oil and gas estate under this agreement or in the Unit Area, or should any party hereto desire to sell, assign or otherwise transfer ownership or control of ownership of the business entity that is a party or a successor to a party to this Agreement, such party shall promptly give written notice to the other parties, with full information concerning its
LTD. owned approximately 75% of the working interest in the Unit.\textsuperscript{292} Altura was owned by AMOCO and Shell. They decided to sell Altura in its entirety. Occidental Petroleum Corporation (Oxy) offered to purchase all of Altura’s assets.\textsuperscript{293} Oxy allocated $63 million of the purchase price to the MFU and this figure was used in the purchase and sale agreement.\textsuperscript{294} Altura sent Fasken a letter notifying it of the sale and of the $63 million allocation. Fasken was given fifteen days to respond if it intended to exercise its preferential right to purchase.\textsuperscript{295}

Fasken requested more information about the sale and complained that it had not received any basis for the $63 million dollar allocation. Fasken also contended that until it received this information, its fifteen day option period would not commence.\textsuperscript{296} Oxy provided some additional information and it agreed to extend the fifteen day deadline but it offered no basis for the allocation other than the statement that it “in good faith considers sixty-three million dollars to be a reasonable allocation of the consideration to the Affected Interest.”\textsuperscript{297} Fasken filed suit

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\textsuperscript{292} \textit{Fasken}, 225 S.W.3d at 581.

\textsuperscript{293} \textit{Id.} at 582.

\textsuperscript{294} \textit{Id.} at 582, 584.

\textsuperscript{295} \textit{Id.} at 585.

\textsuperscript{296} \textit{Id.}

\textsuperscript{297} \textit{Id.} at 586.
and contended that Oxy breached the preferential purchase provision by not providing full information on how the MFU allocation was calculated.\textsuperscript{298} The El Paso Court held that Oxy was not required to do so. The Unit Agreement required any notice of sale to include four things:

1. The name and address of the prospective purchaser, assignee, or transferee (who must be ready, willing and able to purchase or accept the transfer);
2. The purchase price or in the event of the transfer of a business entity or group of properties, an allocation of that portion of the purchase price attributable to its interest in the oil and gas estate under this Agreement or in the Unit Area;
3. A legal description sufficient to identify the property and interest; and
4. All other terms of the proposed sale, or transfer of control or ownership.\textsuperscript{299}

Because the agreement specified what would constitute full information concerning a proposed transaction, and because this did not require any justification for the purchase price allocation, Oxy was not required to provide any additional information on how it allocated the purchase price.\textsuperscript{300}

Attempting to challenge the sufficiency of a notice for failing to provide adequate allocation information also proved problematic for the rightholder in \textit{Koch Industries, Inc. v. Sun Company, Inc.}\textsuperscript{301} Koch had a right of first refusal on Sun’s DeepSea terminal in Corpus Christi. Sun received an offer to buy this facility from Champlin Refining and it provided Koch with

\textsuperscript{298} \textit{Id.} at 589-90.

\textsuperscript{299} \textit{Id.} at 590.

\textsuperscript{300} \textit{Id.}

\textsuperscript{301} 918 F.2d 1203 (5th Cir. 1990).
notice of the proposed sale. Koch complained that Sun’s notice was insufficient because of material differences between Sun’s offer to Koch and Champlin’s proposal. Sun eventually sold the DeepSea facility to Champlin. Koch filed suit seeking specific performance but the trial court found that Koch never evinced an intention to accept Sun’s offer.

Koch challenged the trial court’s holding on appeal arguing, in part, that it did not have sufficient information to make a decision on whether to accept Sun’s offer. Koch relied upon cases such as Foster v. Bullard for support. In that case, the Austin Court of Appeals held that a rightholder was not estopped to assert a preferential right of first refusal six months after the property had been conveyed to a third party because the owner made no attempt to give the rightholder the opportunity to purchase the burdened property.

The Fifth Circuit held that the dispositive question was whether Koch had enough information about the terms of the Champlin deal to make an informed choice about purchasing DeepSea on Sun’s tendered terms. Sun had a duty to make a reasonable disclosure of the offer’s terms, and Koch had a duty to undertake a reasonable investigation of any unclear terms. Because Koch was seeking to impose contractual liability on Sun, it bore the burden of

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302 Id. at 1209-10.
303 Id. at 1211.
304 496 S.W.2d 724 (Tex. Civ. App.—Austin 1972, writ ref’d n.r.e.).
305 Id. at 736.
306 The court cited Martin v. Lott, 482 S.W.2d 917 (Tex. Civ. App.—Dallas 1972, writ denied) for the proposition that “the issue is whether Koch had enough information about the terms of the Chamberlin deal to make an informed choice about purchasing DeepSea on those terms.” Koch Indus., 918 F.2d at 1212.
307 Id. at 1212. Included within the authority relied upon by the court was Ellis v. Waldrop, 656 S.W.2d 902, 904 (Tex. 1983). The court’s description of this holding indicates its belief that an owner need only substantially comply with its duties under a preferential purchase provision to avoid a breach of contract.
proof on this issue.\textsuperscript{308} The court found that Sun made a reasonable disclosure of the Champlin deal.\textsuperscript{309} The record established that Sun sent Koch copies of the proposed agreement with Champlin, including the exhibits and a side agreement. Furthermore, there was correspondence between the parties discussing key provisions of the agreement.\textsuperscript{310} Consequently, Koch had sufficient information on which to make a reasoned decision.\textsuperscript{311} The court contrasted Koch’s investigation with the rightholder’s actions in \textit{Foster}. The court noted that the Foster rightholder made a diligent and prompt investigation of the sale, that it attempted to contact the owner by telephone and mail but was unable to do so, and that its efforts to investigate were unaided in all respects by the owner and third-party purchaser.\textsuperscript{312} The Fifth Circuit’s analysis suggests that in some instances, the lack of information provided by the seller may excuse timely compliance with the owner’s notice, but simply requesting more information is not always sufficient.

\textit{Koch Industries} is also instructive on another issue impacting the rightholder’s decision. When Koch received Sun’s notice it complained repeatedly that Champlin’s proposal and Sun’s offer were significantly different. The Fifth Circuit agreed that there were differences between the two but it did not find that this excused Koch’s duty to make a reasonable investigation.\textsuperscript{313} Consequently, if a rightholder believes that there are material differences between the third-party offer and the owner’s notice and offer, it may be required to take some affirmative action before

\begin{footnotesize}
\textsuperscript{308} \textit{Koch Indus.}, 918 F.2d at 1212 (citing Inc. Carriers, Ltd. v. Crocker, 639 S.W.2d 338, 340 (Tex. App.—Texarkana 1982, no writ); Howell v. Kelly, 534 S.W.2d 737, 740 (Tex. Civ. App—Houston [1\textsuperscript{st} Dist.] 1976, no writ).

\textsuperscript{309} \textit{Koch Indus.}, 918 F.2d at 1212.

\textsuperscript{310} \textit{Id.} at 1213.

\textsuperscript{311} \textit{Id.} at 1214.

\textsuperscript{312} \textit{Id.} at 1212(citing Foster v. Bullard, 496 S.W.2d 724, 737 (Tex. Civ. App.—Austin 1973, writ ref’d n.r.e. ).

\textsuperscript{313} \textit{Id.} at 1213.
\end{footnotesize}
the end of the notice period evidencing an intent to exercise its option by accepting the third-party offer it believes the owner has contractually agreed to accept or, alternatively, file suit before the end of the option period.

For a rightholder, then, it is important to take some affirmative action during the notice period indicating an intention to exercise the option. If the rightholder has questions about the terms of the offer, believes the notice is technically deficient in some way, or has an objection to the terms of the offer, caselaw indicates that it – not the owner or third party - has a duty to inform itself. A rightholder may also be able to preserve a position by filing litigation before the end of the notice period. Finally, caselaw suggests that a rightholder may buy itself more time by asking the owner or third party for more information. But this same caselaw also indicates that the rightholder takes a risk of losing its option if it does anything other than unambiguously accept the offer during the notice period.

IV. LITIGATION.

Because a preferential right to purchase provision is included in every version of the AAPL’s model operating form and there are few cases concerning its application, it is safe to conclude that the parties are normally able to resolve any disagreements. But because there are some reported cases, it is also safe to conclude that there will be instances in which the parties will be unable to reach an agreement and, therefore, that litigation will ensue. The remainder of this paper will address the issues likely to arise in that litigation.

A. What Must the Rightholder Prove?
Most of the reported cases involving preferential purchase rights were filed by the rightholder. Those rightholders have alleged a variety of contractual and tort causes of action. As a plaintiff, the rightholder will have the burden of proof. When considering a party’s burden, it is helpful to review the applicable Pattern Jury Charge. The Texas Pattern Jury Charge for preferential purchase agreement disputes provides:

Did Defendant fail to comply with the Preferential Right to Purchase agreement?

You are instructed that the Preferential Right to Purchase agreement requires Defendant to perform certain obligations as set out more fully in that agreement. As to certain provisions, the Court instructs you that Defendant was obligated as follows:

[Insert applicable provisions] For example, “In the event that Defendant desires to sell his interest in the oil and gas rights subject to this Agreement, he shall first notify the other parties to this Agreement who shall have a preferential right to purchase such interest on the same terms and conditions as those being considered by Defendant.”\(^{314}\)

This instruction assumes that the rightholder is proceeding on a breach of contract claim. If so, this requires proof of (1) a valid contact, (2) that the rightholder performed or tendered

performance under the contract, (3) that the owner breached the contract, and (4) that the rightholder suffered damages as a result of the breach.\textsuperscript{315} The rightholder need not tender performance of the contract but it must plead and prove that it was ready, willing, and able to perform in order to recover damages.\textsuperscript{316}

States such as Kansas recognize an implied duty of good faith and fair dealing from the owner to the rightholder.\textsuperscript{317} This duty requires that parties not intentionally and purposely do anything to prevent the other party from carrying out its part of the agreement or to do anything that will have the effect of destroying or injuring its right to receive the fruits of the contract.\textsuperscript{318} This duty does not, however, ensure the rightholder the opportunity to purchase the burdened property for its fair market value.\textsuperscript{319} The duty of good faith runs from the owner to the rightholder. It does not bind the purchaser. If the purchaser is paying a premium for the properties, the rightholder must match that offer to exercise its preferential right.\textsuperscript{320}

When considering the owner’s duty in the oil and gas context, it is important to remember that despite the disclaimer in most operating agreements that a partnership relationship is not intended, most jurisdictions have concluded that a joint operating agreement creates either a

\textsuperscript{315} See Muenster Hosp. Dist. v. Carter, 216 S.W.3d 500, 505 (Tex. App.—Fort Worth 2006, no pet.).


\textsuperscript{320} \textit{Id.} at 963-64.
mining partnership or a joint venture. In those jurisdictions, the owner would have a fiduciary duty to the rightholder if the preferential purchase right is created by a clause in the joint operating agreement. It is possible, therefore, that caselaw developed in response to preferential rights disputes involving commercial leases would not adequately describe the owner’s duty in an oil and gas dispute.

Contractual disputes between the rightholder and the owner can arise in a multitude of situations but the most likely conflict in a package transaction is the purchase price allocated to the burdened property. The rightholder will inevitably argue that the allocation overstates the property’s value — if for no other reason than to create a reason for the purchaser to negotiate a waiver of the preferential right. If the dispute is unresolved and it proceeds to trial, presumably the rightholder will have expert testimony on the burdened property’s fair market value.

Fair market value evidence is clearly relevant but it alone is not legally sufficient to establish a breach. In the typical preferential rights agreement, the rightholder is entitled to

321 Conine, supra note 20, at 1274.


323 TEX. R. EVID. 401 defines relevant evidence as “evidence having any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence. Because a package transaction reflects the value of all of the assets, competent evidence of the fair market value of a single asset will generally be relevant. That, however, is not the end of the analysis. See Transp. Ins. Co. v. Moriel, 879 S.W.2d 10, 24-25 (Tex. 1994) (simply because evidence makes a fact that is of consequence to the determination of the action more or less probable and, therefore, material, does not render the evidence legally sufficient: “As Professor McCormick succinctly put it, ‘a brick is not a wall.’”(citing CHARLES T. MCCORMICK, HANDBOOK OF THE LAW OF EVIDENCE § 152 (West ed. 1954)).
purchase the burdened property on the same terms and conditions as offered by a third-party.\textsuperscript{324} In a single asset sale, a third-party offer will reflect a fair market valuation.\textsuperscript{325} But in a package transaction, the number of potential variables impacting the total price makes it less likely that the total price reflects simply the total fair market valuations of the individual components. More, therefore, is arguably required.

For example, consider \textit{Fasken Land and Minerals, Ltd. v. Occidental Permian Ltd.}\textsuperscript{326} The rightholder retained a consulting petroleum engineer who was asked to determine the fair market value of the working interest being sold. He was able to do so but because he did not evaluate the fair market value of all of the properties being sold he could not do an allocation of the purchase price.\textsuperscript{327} One could argue that if the rightholder focuses exclusively on the fair market value of the burdened property and does not address the overall allocation of the purchase price, it has not carried its burden of proof. Obviously, the rightholder need not challenge the allocation of every nonburdened property because the ultimate question is “What did the owner agree to sell the burdened property for?” But, it needs sufficient information about the allocation process to justify its criticism of the burdened property’s allocation. For example, if every similar nonburdened property was allocated a value approximate to its fair market value, then the fair market value of the burdened property becomes more persuasive. But mere testimony of a

\textsuperscript{324} See, e.g., Holland v. Fleming, 728 S.W.2d 820, 823 (Tex. App.—Houston [1st Dist] 1987, writ ref’d n.r.e.).

\textsuperscript{325} See Edlund v. Bounds, 842 S.W.2d 719, 728 (Tex. App.—Dallas 1992, writ denied) (“the actual sales price of property provides some evidence of fair market value.”).

\textsuperscript{326} 225 S.W.3d at 577.

\textsuperscript{327} Id. at 585 n. 10.
burdened property’s fair market value -- without any supportable conclusion on how that reflects upon the allocation of the purchase price -- is insufficient.\textsuperscript{328}

The Texas Supreme Court has held that a party with the burden of proof must present sufficient evidence to permit the logical inference the jury must reach.\textsuperscript{329} In this regard, there must be a logical connection, direct or inferential, between the evidence offered and the fact to be proved.\textsuperscript{330} If the owner’s contractual obligation is to offer the burdened property on the same terms and conditions as was offered by a third party, then the right holder must present evidence that the terms it was given differ from those offered by the third party. In the case of an allocation dispute, this would require proof that the allocation does not reflect what the burdened property is, in fact, being sold for.

On T.V., or in a John Grisham novel, the key piece of evidence would materialize at the 11\textsuperscript{th} hour due to the heroic action of the protagonist and would be a dramatic smoking gun that harbored no other conclusion but that the bad guys were trying to cheat a poor, innocent victim. In the real world, however, such dramatics are rare. How, then, does a rightholder challenge an allocated price? Invariably, this involves a lot of detective work. For starters, a review of any correspondence or emails between the parties and any draft agreements will shed some light not only on the issues discussed but may reveal important information on who did the allocation and whether any adjustments to the value of the burdened property were made during the

\textsuperscript{328} See Uno Rests., Inc. v. Boston Kenmore Realty Corp., 805 N.E.2d 957, 963 (Mass. 2004) (rightholder presented evidence that burdened property was allocated a price above its fair market value but did not present any evidence that nonburdened property was allocated prices below their fair market value. The jury, therefore, had no basis upon which to determine that prices were allocated improperly).

\textsuperscript{329} Transp. Ins. Co. v. Moriel, 879 S.W.2d 10, 24 (Tex. 1994).

\textsuperscript{330} Lyons v. Millers Cas. Ins. Co., 866 S.W.2d 597, 600 (Tex. 1993).
negotiations. Of more consequence is a review of the allocation process. Who did it? What method was used? Did valuation numbers change at any point and, if so, why? A related inquiry will be when did the allocating party learn that the tract in question was subject to a preferential purchase right?

Absent a remarkable admission, a rightholder will have no direct evidence that the allocation values were used to defeat its preferential right. A plaintiff can, however, use circumstantial evidence to establish a material fact so long as that evidence transcends mere suspicion.331 The material fact must be a reasonable inference from the known circumstances.332 At some point, however, circumstantial evidence becomes merely speculative. For example, there will, by necessity, be a number of conversations between the owner and third-party buyer concerning the transaction and, ordinarily, many of these will address the allocation of the purchase price. Thus, the fact that the valuation of a particular property changed after a conversation, standing alone, has limited probative value.333 The ultimate guidepost for determining when speculation goes too far is the rule that one inference cannot be stacked upon

331 Lozano v. Lozano, 52 S.W.3d 141, 149 (Tex. 2001) (Phillips, C.J., concurring and dissenting). See also Browning-Ferris, Inc. v. Reyna, 865 S.W.2d 925, 927 (Tex. 1993) (“By its very nature, circumstantial evidence often involves linking what may be apparently insignificant and unrelated events to establish a pattern.”).

332 Id.

333 See, e.g., Browning-Ferris, 865 S.W.2d 925 (evidence of contact between the Highway Department and BFI may prove that BFI was a willing participant in the State’s wrongful conduct but it was no evidence that BFI acted improperly). See also Schlumberger Well Surveying Corp. v. Nortex Oil and Gas Corp., 435 S.W.2d 854, 857 (Tex. 1968) (one without knowledge of the object and purpose of a conspiracy cannot be a co-conspirator).
another. Or stated differently, a jury may not infer an ultimate fact from circumstantial evidence that could give rise to any number of inferences, none more probable than another.

B. Rightholder’s Remedies.

Courts that do not recognize a package sale as triggering a right of first refusal generally allow the rightholder to seek an injunction blocking the sale. If the sale has already concluded, these courts often reconvey the property to the original owner and enjoin further sale until the owner receives a separate offer for the burdened property. The purpose of the

334 Id. at 858 (conspiracy may be proven through circumstantial evidence but burden of proof cannot be sustained through inference stacking); Green v. Tex. & Pac. Ry. Co., 125 Tex. 168, 81 S.W.3d 669 (1935) (“To establish a fact by circumstantial evidence, the circumstances relied on must have probative force sufficient to constitute the basis of a legal inference. It should not be of such character as to permit of purely speculative conclusions.”).

335 Hammerly Oaks, Inc. v. Edwards, 958 S.W.2d 387, 392 (Tex. 1997). See also Marathon Corp. v. Pitzner, 106 S.W.3d 724, 729 (Tex. 2003) (“[I]n cases with only slight circumstantial evidence, something else must be found in the record to corroborate the probability of the fact’s existence or non-existence.”).


injunction is not only to allow the purchaser to make a separate offer for the burdened property but to spare the court from determining the portion of the total price to be allocated to the burdened property and from forcing terms on the owner to which he has not agreed.\textsuperscript{338} Attempts by the rightholder to force a sale to it of the burdened property at a fair and equitable price have generally failed.\textsuperscript{339}

Courts that do recognize a package sale as triggering a right of first refusal most often grant specific performance on the right.\textsuperscript{340} These courts generally recognize the right of first refusal as entitling the rightholder to purchase only the burdened property. However, a few courts have indicated that the rightholder must agree to purchase the entire package in order to exercise the right.\textsuperscript{341} Some states have allowed damages for violation of a right of first refusal.\textsuperscript{342}

\textsuperscript{338} See Chapman, 800 P.2d at 1152 (“It is undesirable for a court to reform the contract by placing a value on the property. If at all possible, that should be left to the parties and the market they choose to contract in. . . . Returning the parties to the positions they occupied before the attempted sale of the larger parcel recognizes their agreement and provides the opportunity for its performance without judicial intrusion into establishment of the price term of any desired sale.”).

\textsuperscript{339} See, e.g., L.E. Wallach, 113 A.2d at 261.


\textsuperscript{341} In re New Era Resorts, LLC, 238 B.R. 381, 387 (Bankr. E.D. Tenn. 1999); see Crow-Spieker No. 23, 731 P.2d at 350 (alternative holding that rightholder did not match terms of third-party offer by refusing to buy larger tract and by offering to buy burdened tract at less than market value).
Rights of First Refusal and Package Oil and Gas Transactions

One federal court held that damages may be the only available remedy when the operating agreement has not been properly recorded if the transferee has no actual or constructive knowledge of the preferential right provision. These courts also frequently grant equitable relief comparable to that awarded by states that do not hold a preferential right is triggered by a package sale. For example, if an owner fails to afford a rightholder the opportunity to exercise its preferential right, courts have enjoined sales if the rightholder is notified before the transaction is consummated or have ordered a reconveyance and enjoined any further transactions if the rightholder learns of the transaction after the conveyance is consummated.

Some states have enjoined package sales unless and until a separate offer is made for the burdened property. Other states have imposed a pro rata allocation of the purchase price and have then given the rightholder the opportunity to purchase the burdened property at that price. Still other courts have allowed the rightholder to purchase the entire package.

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342 Anderson v. Armour & Co., 473 P.2d 84, 89 (Kan. 1970) (damages awarded to lessee who had improvements on burdened tract assessed the value of tract with improvements compared to value of tract without improvements); Nelson v. Reisner, 331 P.2d 17, 23 (Cal. 1958) (evidence of per-acre profit made by lessee and other farmers on comparable land where same crops were grown sufficient to prove damages). But cf. Chapman, 800 P.2d at 1152 (monetary damages are unnecessary when the parties can be restored to their former positions without suffering irreparable harm).


346 See, e.g., Wilson v. Brown, 55 P.2d 485 (Cal. 1936) (rightholder allowed to purchase burdened property for a price determined by the trial court to represent its reasonable value); Moron v. Howard, 66 Cal. Rptr. 70, 79 (Ct. App. 1968) (because the parties did not allocate a portion of the purchase price to the burdened property and because
Finally, some states have taken a different tact by focusing on the third party. For example, if the third-party purchaser is aware of a preferential right but fails to determine if the rightholder wishes to exercise it, the purchaser is not a good faith purchaser and is subject to a decree of specific performance.348 Where the burdened property is intentionally valued disproportionately to discourage the exercise of the preferential right, one commentator has suggested that tort liability may lie.349

In Pantry Pride Enterprises, Inc. v. Stop & Shop Companies, Inc.,350 the court indicated that the appropriate remedy may depend upon the type of transaction involved. The court noted it is not unreasonable to assume that the property was sold for its fair market value, it was neither unfair nor inequitable for the trial court to ascertain the property’s fair market value and to order specific performance at this price); Denco v. Belk, 97 So. 2d 261 (Fla. 1957) (specific performance available at a price to be set by the court); Garmo v. Clanton, 551 P.2d 1332 (Idaho 1976) (it was appropriate for the trial court to determine the fair market value of burdened property and to allow the rightholder to exercise its option at that price); Brenner v. Duncan, 27 N.W.2d 320 (Mich. 1947) (rightholder granted specific performance at a price to be set by determining the burdened property’s percentage of the value of the entire package and then multiplying this against the total purchase price); Berry-Iverson Co. of N.D., Inc. v. Johnson, 242 N.W.2d 126, 135-36 (N.D. 1976) (allowing rightholder to exercise option on burdened property using the per-acre price offered for a larger package apparently because there was no evidence that the fair market value of the burdened tract was higher than that of the tract as a whole).


350 806 F.2d 1227 (4th Cir. 1986).
that a majority of courts had held that an injunction is the rightholder’s sole remedy. These cases, however, usually involve the sale of leased property burdened by a preferential right along with adjacent property, and in most instances, the owner is attempting to force the rightholder to either purchase the entire package or allow the sale to take place. In this situation, specific performance may be inequitable because it would deprive the lessor of a premium from selling the properties together, it may be difficult to sell the properties separately, and it forces the owner to separate leased and unleased portions of contiguous properties. Because the court was facing a different situation – a package sale of several shopping centers--the court held that the rightholder was entitled to specific performance at a price to be determined by considering the burdened property’s value as a percentage of the value of the shopping center as a whole.

If a state imposes injunctive relief that effectively blocks the consummation of a larger transaction, the net effect may be to force the owner to obtain the rightholder’s consent to the sale or a waiver of its right of first refusal – for consideration of course -- or to renegotiate the proposed transaction with the buyer so that the burdened property is no longer part of the package or the purchase price allocation is reallocated in a way to satisfy the rightholder or the court.

Texas Courts have held that when the rightholder learns of a sale in violation of its preferential right to purchase, it then has the opportunity to either accept or reject within the

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351 Id. at 1229.
352 Id. at 1230.
353 Id. at 1232. The court accepted the owner and purchaser’s allocation of the value of the shopping center as a whole. If, for example, the trial court determined that the burdened property constituted one-fourth of the value of the shopping center, then the rightholder would be entitled to exercise its preferential right by paying one-fourth of the allocated value.
specified time frame just as if the offer to buy had been properly noticed.\footnote{A.G.E., Inc. v. Buford, 105 S.W.3d 667, 673(Tex. App.—Austin 2003, pet. denied).} If the buyer refuses to sell, the rightholder is entitled to specific performance.\footnote{Martin v. Lott, 482 S.W.2d 917, 920 (Tex. Civ. App.—Dallas, 1972, no writ).} This specific performance is limited to the burdened property. The rightholder cannot be required to purchase the entire package of properties being sold.\footnote{See McMillan v. Dooley, 144 S.W.3d 159, 171 (Tex. App.—Eastland 2004, pet. denied); Riley v. Campeau Homes (Tex.) Inc., 808 S.W.2d 184, 189 (Tex. App.—Houston [14th Dist.] 1991, writ dism’d by agr.); Hinds v. Madison, 424 S.W.2d 61, 64 (Tex. Civ. App.—San Antonio 1968, writ ref’d n.r.e.) (“We do not see how in any way lessee’s option or preference right to purchase a portion of the property sought to be sold can be enlarged to cover other lands owned by lessors, or can in any manner cover anything except the property actually subject to the option.”).}

C. Buyer and Seller’s Affirmative Defenses.

The owner and purchaser can potentially raise waiver as a defense if the rightholder delays taking action after learning of a potential violation of its preferential right. Waiver can be asserted against a party who intentionally relinquishes a known right or engages in conduct inconsistent with claiming that right.\footnote{Sun Exploration & Prod. Co. v. Benton, 728 S.W.2d 35, 37 (Tex. 1987).} For example, the express renunciation of a known right establishes waiver.\footnote{Alford, Meroney & Co. v. Rowe, 619 S.W.2d 210, 213 (Tex. Civ. App.—Amarillo 1981, writ ref’d n.r.e.).} Silence or inaction, for so long a period as to show an intention to yield the known right, is also enough to prove waiver.\footnote{Id. at 213.} Similarly, when the rightholder’s preferential
right is created by a lease, that right must be exercised and any action necessary to claim that right taken during the life of the lease.\(^{360}\)

In *A.G.E., Inc. v. Buford*,\(^{361}\) the rightholder was the lessee of a commercial tract. The original lessor, Paul Water, leased the tract to Ralph Moreland. The lease was for forty years and it gave Moreland the right to purchase the property on the same terms as any contemplated sale.\(^{362}\) The lease required Walter to provide 30 days notice before any contemplated sale.\(^{363}\) Walter passed away and he left the property to his daughter. She conveyed a 24.7% interest in the property to Henderson Buford in exchange for legal fees rendered in connection with her father’s probate proceeding.\(^{364}\) Moreland had, meanwhile, assigned his interest in the lease to Citizens State Bank. Neither Moreland nor Citizens received notice of the assignment to Buford.\(^{365}\) Citizens then assigned its interest to Mid Texas Bancshares, Inc. Buford later acquired the remainder of the daughter’s interest but did not initially provide notice to Citizens or Mid Texas.\(^{366}\) When Buford informed Mid Texas that he had acquired the remainder of the property, it protested that its right of first refusal had been breached and it threatened to file suit unless he consented to a new sublease.\(^{367}\) Buford consented and Mid Texas subleased the


\(^{361}\) 105 S.W.3d 667, 667 (Tex. App.—Austin 2003, pet. denied).

\(^{362}\) *Id.* at 671.

\(^{363}\) *Id.*

\(^{364}\) *Id.*

\(^{365}\) *Id.*

\(^{366}\) *Id.*

\(^{367}\) *Id.*
property to A.G.E. the next month. More than three years later, Mid Texas assigned its interest in the leasehold, including the right of first refusal and any claim for the violation of that right, to A.G.E.\textsuperscript{368} A.G.E. then notified Buford of its intent to exercise the right of first refusal for what it calculated Buford had acquired the property less its damages.\textsuperscript{369} The Austin Court of Appeals held that when Mid Texas learned of the sale to Buford, it had the opportunity at that point in time to exercise its option.\textsuperscript{370} Because it instead sought a sublease from Buford, its first refusal right expired when he consented to the sublease.\textsuperscript{371} Because Mid Texas elected not to exercise its option, it had no right concerning Buford’s acquisition of the property to assign to A.G.E..\textsuperscript{372}

Another possible defense is the statute of frauds. To be enforceable, an agreement to convey real property and a conveyance of real property must provide within the document itself or by reference to some other existing writing, the means or data by which the land to be conveyed may be identified with reasonable certainty.\textsuperscript{373} This issue is unlikely to arise if the preferential purchase right was created by the joint operating agreement because they typically have legally-sufficient descriptions of the contract area.\textsuperscript{374} The issue can, however, arise in other

\textsuperscript{368} Id.

\textsuperscript{369} 105 S.W.3d at 671. A.G.E. claimed damages for the rent paid during Buford’s ownership, lost profits, and stop gap repairs to the building.

\textsuperscript{370} Id. at 673-74.

\textsuperscript{371} Id.

\textsuperscript{372} Id.

\textsuperscript{373} Morrow v. Shotwell, 477 S.W.2d 538, 539 (Tex. 1972).

\textsuperscript{374} Conine, \textit{supra} note 20, at 1373 (the usual forms of operating agreements are sufficient to satisfy the statute of frauds provided care is taken in their use).
contexts. For example, a letter agreement may not have a legally sufficient property description because of its informal nature.

In *Reiland v. Patrick Thomas Properties, Inc.*, a Houston Court of Appeals held that a description of land contained in a right of first refusal was legally inadequate and violated the statute of frauds. In 1977, Leonard Bythel Weis and Marjorie K. Weis granted Beverly Faulkner a right of first refusal in a tract of real property. The tract was identified as “3.0152 acres adjoining on the east side that 1.984 acre tract conveyed by Leonard Bythel Weis and wife, Marjorie K. Weis to Beverly Faulkner, Trustee on or about February 18, 1977” and “as being 3.0152 acres in the William Waters Survey, Abstract 851, Harris County, Texas.” No metes and bounds description was attached to the right of first refusal. In 1999, the Leonard B. Weiss Trust conveyed the tract to Reiland. Faulkner was unaware of the conveyance, and five years later she assigned the right of first refusal to Patrick Thomas Properties, Inc. PTP eventually learned of the 1999 conveyance and sued Reiland to enforce the right of first refusal. The court of appeals held that the description set out in the right of first refusal did not indicate the boundaries or the metes and bounds of the tract with sufficient definiteness to locate the 3.1052 acres and, thus, it violated the statute of frauds.

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376 *Id.* at 434.
377 *Id.* at 436.
378 *Id.* at 434.
379 *Id.*
380 *Id.* at 437-38. *Cf.* Wiggins v. Cade, 313 S.W.3d 468, 471-73 (Tex. App.—Tyler 2010, pet. denied) (property description that begin with a reference to the northwest corner of a 45 acre tract formerly owned by Mrs. Kate Crook was sufficient because there was only one 45 acre tract owned by Mrs. Crook in the county).
Even though preferential purchase rights restrict the alienation of property, parties normally cannot assert the rule against perpetuities as a defense.\footnote{381} Courts have employed several rationales for this. For example, the Fifth Circuit relied upon a policy analysis to find that it did not apply to a preemptive right burdening an oil and gas lease.\footnote{382} The court noted that the preferential right was not an exclusive option to buy at a fixed price at a remote time but simply gave the rightholder the right to buy at market price whenever the lessee desired to sell. It did not restrain alienation because the rightholder could not prevent a sale.\footnote{383} The Oklahoma Supreme Court utilized a similar analysis to hold the rule did not apply to a preferential purchase right created by a lease operating agreement.\footnote{384} Other courts have held that an option creates no

\footnote{381} Conine, \textit{supra} note 20, at 1379 n. 457; Cherokee Water Co v. Forderhause., 641 S.W.2d 522, 526 (Tex. 1982) (agreeing with the reasoning of the court or appeals, 623 S.W.2d 435, 439-40 (Tex. Civ. App—Texarkana 1981), that a right of first refusal with no fixed price and only exercisable when owner receives a bona fide third party offer does not violate the rule against perpetuities). Power Gas Mktg. & Transmission, Inc. v. Cabot Oil & Gas Corp., 948 A.2d 807, 810, 814 (Pa. Sup. Ct. 2008) (holding a preferential right to purchase is a right of first refusal and not an option agreement since it granted the parties the right to purchase for consideration and did not require an offer to sell at all. “[T]he interest created by the JOA preferential purchase rights provision is the right to purchase a percentage interest in an ever-changing aggregation of leases, wherein each lease contains varying terms.”)

\footnote{382} Weber v. Texas Co., 83 F.2d 807, 808 (5th Cir. 1936), \textit{cert. denied}, 299 U.S. 561, 57 S.Ct. 23, 81 L.Ed. 413 (1936).

\footnote{383} \textit{Id.} at 808. The Wyoming Supreme Court followed this analysis and found that a preemptive right in a joint venture agreement did not violate the rule against perpetuities. Hartnett v. Jones, 629 P.2d 1357, 1362-63 (Wyo. 1981).

\footnote{384} Producers Oil Co. v. Gore, 610 P.2d 772 (Okla. 1980), \textit{agreeing with} Producers Oil Co. v. Gore, 437 F.Supp. 737 (E.D. Okla. 1977). The Tenth Circuit certified this question: “Does the Oklahoma Rule Against Perpetuities apply to the interest created by the preemptive option provisions of the oil and gas lease operating agreements described below?” The Oklahoma Supreme Court responded no.
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interest in the land. Some courts have concluded that an option creates a vested interest in the property, and that since the interest is presently vested there is no reason to invoke the rule because it assumes a future vesting. Still others have concluded that an option is a personal right and not an interest in property and, therefore, is not inhibited by a rule relating only to real property. In still other jurisdictions, the rationale has been that a preemptive right is an exception to the rule because it creates an estate on a condition subsequent to which the rule does not apply.

The Texas Supreme Court has, however, held that preferential purchase provisions that restrict the free transfer of stock should be narrowly construed. An owner or third-party purchaser could make a similar argument when the preferential right applies to a tract of land or mineral interest. It is also a defense that the rightholder did not have the financial ability to pay for the burdened property at the time of the conveyance. Similarly, a rightholder who was not

387 Mercer v. Lemmens, 40 Cal. Rptr. 803 (Ct. App. 1964); Frissell v. Nichols, 114 So. 431 (Fla. 1927); Dodd v. Rotterman, 161 N.E. 756 (Ill. 1928).
388 Dozier v. Troy Drive-In-Theaters, 89 So. 2d 537 (Ala. 1956); Hollander v. Cent. Metal & Supply Co. of Balt. City, 71 A. 442 (Md. 1908).
390 See, e.g., Kanavos v. Hancock Bank & Trust Co., 479 N.E.2d 168 (Mass. 1985) (holding that rightholder has the burden of proving financial ability to meet the third-party buyer’s offer).
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willing to perform and would have declined to exercise the option suffers no legal damage from the owner’s breach of contract. 391

D. Third-Party Buyer’s Remedies.

The leading case on a third-party buyer’s remedies is Abraham Investment Co. v. Payne Ranch, Inc. 392 The owners of the Payne Ranch agreed to sell the ranch to Abraham Investment Company (AIC). The ranch was subject to a preferential right of purchase in favor of Campbell, a lessee under a grazing lease. 393 AIC’s contract was made subject to this provision. AIC agreed to pay $35,000 when it signed the contract and $673,540 by cashier’s check the following day. 394 Campbell was notified of the sale and was provided a copy of a proposed contract from prior negotiations. Campbell was given 20 days to exercise his option on the same terms as contained in the proposed contract. Campbell’s notice required him to exercise his option in writing. 395 Shortly thereafter, Campbell received a second notice letter with a copy of the actual purchase agreement. Campbell met with the owner’s representatives and verbally expressed his intent to

391 Koch Indus., Inc. v. Sun Co., 918 F.2d 1203, 1214 (5th Cir. 1990).


393 The preferential right was defined as:

This letter is written for the purpose of giving to you the preferential right of purchase of the property described in the attached Exhibit “A” in the event of a sale of such property. You hold a five-year grazing lease on such property effective December 1, 1987, subject to termination on one year’s notice in the event of a sale of such property.

Id. at 522.

394 Id.

395 Id. at 523.
exercise his preferential right. During their discussions, Campbell proposed paying $35,000 down and the remainder over six months with 12% interest. The owners agreed, Campbell signed the second notice letter, and the following day the parties executed a warranty deed and a vendor’s lien note.\textsuperscript{396}

AIC filed suit and alleged contract and tort causes of action. It sought specific performance, tort damages, or, alternatively, breach of contract damages.\textsuperscript{397} The ranch owners and Campbell argued that AIC lacked standing. The Amarillo Court disagreed. AIC’s contract was made subject to Campbell’s preferential right of purchase. Because AIC’s contractual rights were dependent upon whether Campbell properly exercised his preferential right, this created a condition subsequent.\textsuperscript{398} If Campbell did not exercise his preferential right, the owners were contractually obligated to sell the ranch to AIC. This gave AIC standing.\textsuperscript{399}

The next question was whether Campbell properly exercised his preferential right. This required consideration of both the terms of the preferential right provision and the notice letter.\textsuperscript{400} The notice letter required a written acceptance. Consequently, Campbell’s oral

\textsuperscript{396} \textit{Id.}

\textsuperscript{397} \textit{Id.} at 522.

\textsuperscript{398} \textit{Id.} at 524. \textit{See also} Rincones v. Windberg, 705 S.W.2d 846 (Tex. App.—Austin 1986, no writ) (“a condition subsequent is ‘a condition referring to a future event, upon the happening of which the obligation becomes no longer binding upon the other party, if he chooses to avail himself of the condition.’” (citing Baker v. Baker, 183 S.W.2d 724, 728 (Tex. 1944))).

\textsuperscript{399} Abraham, 968 S.W.2d at 524.

\textsuperscript{400} \textit{Id.} at 525 (citing Henderson v. Nitschke, 470 S.W.2d 410, 413-14 (Tex. Civ. App.—Eastland 1971, writ ref’d n.r.e.)).
commitment was insufficient.401 The court recognized that Campbell signed the second notice letter, but held that this did not create a contract because of the differences between that letter and AIC’s contract.402 The court also noted that Campbell had no intention of complying with the terms of the second notice letter because the parties had already agreed to alter the agreement by allowing Campbell to finance his acquisition.403 When Campbell received the notice letter, an irrevocable option was created.404 Normally, Campbell’s choices were limited to accepting or rejecting the offer. The court held that Campbell’s counter-offer involving a six-month financing term did not reject the offer but that Campbell was still required to accept the offer presented by the first notice letter.405 Because he did not, Campbell did not properly exercise his preferential right.406

The court also considered the propriety of the owners’ actions. Because the first notice letter created an irrevocable option, the owners could not change the terms of the offer.407 Normally, this would protect the rightholder’s interest by ensuring that it receives the full benefit

401 Id. (citing Town of Lindsay v. Cooke County Elec. Coop. Ass’n, 502 S.W.2d 117, 118 (Tex. 1973), cert. denied, 416 U.S. 970, 94 S.Ct. 1993, 40 L.Ed.2d 559 (1974)).

402 Id. at 526. Specifically, the court noted that AIC’s contract specified the cash payment dates but the contract attached to the notice letter did not, and that the first notice letter required Campbell’s acceptance within 20 days but the second notice letter contained no deadline.

403 Id. (citing W.R. Larock, D.C., P.C. v. Enagnit, 812 S.W.2d 670, 671 (Tex. App.—El Paso 1991, no writ), for the proposition that “no contract is formed by the signing of an instrument when one party is aware that the other party does not intend to be bound by the wording of the instrument.”)

404 Id. (because the preferential right was supported by consideration, the option was irrevocable).

405 Id.

406 Id. at 527.

407 Id. at 526 (citing W. Tex. Transmission, L.P. v. Enron Corp., 907 F.2d 1554, 1563 (5th Cir. 1990)).
of its option. However, it may also give protection to a third-party buyer. Because Campbell’s preferential purchase right was a condition subsequent, not only did the notice letter define Campbell’s contractual rights it defined AIC’s as well. AIC could, therefore, insist that the ranch owners take no action to contravene its contractual right to purchase the ranch.

Having found that Campbell did not properly exercise his preferential right and, therefore, that AIC’s contractual rights were violated, the next question was to what remedy was it entitled? The owners had executed a warranty deed to Campbell and he had entered into a loan agreement with Maltese Cross that was secured by the ranch and bank stock.\(^{408}\) Thus, title was in Campbell’s name and his interest was encumbered. The general rule is that a purchaser of real estate is entitled to specific performance of a contract for the sale of land when the contract is valid and enforceable and when the terms of the contract are sufficiently clear so that the parties know of their obligations under the contract.\(^{409}\) If the seller breaches a contract to sell land and then sells the land to another purchaser who has knowledge of the initial contract, the subsequent purchaser stands in the shoes of the original seller and may be compelled to convey title.\(^{410}\) Because Campbell’s purchase did not comply with his preferential right and because he had knowledge of the AIC contract, he was required to comply with that contract by conveying the ranch to AIC.\(^{411}\)

\(^{408}\) Id. at 523.

\(^{409}\) Langley v. Norris, 173 S.W.2d 454, 459 (Tex. 1943); Goode v. Westside Developers, Inc., 258 S.W.2d 844, 845-46 (Tex. Civ. App.—Waco 1953, writ ref’d n.r.e.).

\(^{410}\) Langley, 173 S.W.2d at 457.

\(^{411}\) Abraham, 968 S.W.2d at 527.
The court also found that AIC was entitled to remove the cloud of Maltese Cross’s mortgage from its title.412 Maltese Cross could not establish that it was a bona fide mortgagee because it could not prove that it acquired its interest in good faith, for value, and without notice of a claim asserted by a third party.413 Maltese took its lien with full knowledge of AIC’s claim. A lawsuit and a *lis pendens* notice had been filed when Campbell and Maltese executed their mortgage agreement, and their agreement expressly acknowledged the pending lawsuit.414

AIC also sought tort damages. The court found that it had waived claims for fraud, trespass, and violation of the Deceptive Trade Practices Act415 by failing to offer any supporting arguments on appeal.416 The court did find, however, that AIC had preserved claims for civil conspiracy and tortious interference. AIC argued that Campbell had exercised undue influence over a ranch representative in order to obtain the ranch on different terms from that which he was entitled and that Campbell was acting as an agent for Maltese Cross. The court found that AIC raised a genuine issue of material fact on these claims and remanded them to the trial court for further consideration.417

Conspiracy and tortious interference claims are similar, but tortious interference claims are the most common in contractual situations and they give a third-party purchaser who believes its contract was breached in favor of a preferential rightholder a powerful pretrial negotiating weapon and a potential source of recovery at trial. To recover for tortious interference with an

412 *Id.* at 527-28.

413 *Houston First Am. Sav. v. Musick*, 650 S.W.2d 764, 769 (Tex. 1983).

414 *Abraham*, 968 S.W.2d at 527-28.

415 *TEX. BUS. & COM. CODE ANN.* §§ 17.41-63 (Vernon -).

416 *Abraham*, 968 S.W.2d at 528.

417 *Id.* at 528.
existing contract, a plaintiff must show (1) the existence of a contract subject to interference; (2) a willful and intentional act of interference; (3) that was a proximate cause of the plaintiff’s damages; and (4) actual damage or loss.\footnote{Tex. Beef Cattle Co. v. Green, 921 S.W.2d 203, 210 (Tex. 1996); Browning-Ferris, Inc. v. Reyna, 865 S.W.2d 925, 926 (Tex. 1993).} Ordinarily, merely inducing a contract obligor to do what it has a right to do under the contract is not actionable interference.\footnote{ACS Investors, Inc. v. McLaughlin, 943 S.W.2d 426, 430 (Tex. 1977).} The third party must prove that the rightholder induced the owner to breach the contract or wrongfully interfered with the parties’ ability to perform under that contract.\footnote{See COC Svs., Ltd. v. CompUSA, Inc., 150 S.W.3d 654, 672 (Tex. App.—Dallas 2004, pet. denied) (tortious interference claimant was required to prove that defendants induced CompUSA to breach a Master Franchise Agreement or wrongfully interfered with the parties’ ability to perform under that agreement).} A successful claimant can recover both actual damages and punitive damages. In real estate transactions, these can be significant.\footnote{See, e.g., SJW Prop. Commerce, Inc. v. Sw. Pinnacle Props., Inc., 328 S.W.3d 121 (Tex. App.—Corpus Christi 2010, pet. filed) (plaintiffs were awarded actual damages of $874,890.70 and punitive damages of $2,376,397).}

An action for declaratory judgment might also be available. A matured breach of contract action is explicitly covered by the Declaratory Judgments Act.\footnote{Tex. Civ. Prac. & Rem. Code § 37.004(b) (“[a] contract may be construed either before or after there has been a breach.”); MBM Fin. Corp. v. Woodlands Operating Co., L.P., 292 S.W.3d 660, 667 (Tex. 2009).} The existence of another adequate remedy does not bar an action for declaratory judgment unless the action would interfere with some other exclusive remedy or some other entity’s exclusive jurisdiction.\footnote{Id. at 669.} Examples of an exclusive remedy would be a trespass to try title action for determining title under the Texas Property Code.\footnote{Martin v Amerman, 133 S.W.3d 262, 267 (Tex. 2004) (citing Tex. PROP. CODE § 22.001(a)). If a declaratory judgment action is an option, an award of
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attorney’s fees might be available.\textsuperscript{425} However, if the declaratory judgment action is tacked on to a standard suit based on a matured breach of contract for which no damages are awarded, attorney’s fees are not recoverable.\textsuperscript{426} In this situation, the Supreme Court has determined that awarding attorney’s fees for the declaratory judgment action would allow parties to plead around the more general limitation on attorney’s fees governing breach of contract actions.\textsuperscript{427}

A third-party buyer’s proof of a contract and actual damages will be the same no matter if it is suing the owner, the rightholder, or both. But the proof of a willful and intentional act that was the proximate cause of a buyer’s damages must be specific to the defendant sued. If the buyer can show only that one party engaged in improper conduct, the mere fact that the other was a willing participant is insufficient to establish a cause of action against the participant.\textsuperscript{428}

VI. Conclusion.

Preferential purchase right agreements burdening one or more but not all of the properties being sold as part of a package transaction cause difficulty, primarily because the agreement creating the right fails to specifically address what the parties’ rights and duties will be in such a situation. Consequently, if the parties want a preferential purchase agreement, the best method for avoiding the complications caused by package transactions is to address them in the preferential purchase provision. Because the AAPL Model Operating Agreements do not, if the

\textsuperscript{425} TEX. CIV. PRAC. & REM. CODE § 37.009 (Vernon).

\textsuperscript{426} MBM Fin. Corp., 292 S.W.3d at 670.

\textsuperscript{427} Id.

\textsuperscript{428} Browning-Ferris, Inc. v. Reyna, 865 S.W.2d 925, 927 (Tex. 1993) (plaintiff’s proof that the State acted improperly combined with proof that there was contact between the State and BFI was not sufficient to prove a tortious interference claim against BFI).
agreement will be part of the joint operating agreement, the parties should substitute their own provision for the AAPL’s proffered provision.

If this advice comes too late, the owner and third-party buyer can best avoid unnecessary complication by focusing on the allocation process. Current culture promotes transparency in a number of contexts, particularly in political discourse, as a solution to any number of problems. It can actually be effective in package transactions. A process that looks fair and was applied consistently to burdened and nonburdened properties alike is compelling. The allocating party should, therefore, consider how it would defend its allocation if challenged by the rightholder and how its explanation would be received by a neutral third-party.

Rightholders must be vigilant. If they receive a notice and have any questions, care should be taken to educate themselves prior to the end of the notice period. Rightholders should be cognizant of the fact that a court may not require the owner or third-party to disclose anymore information than specifically required by the preferential right provision, and that a court may require them to take some action accepting the offer within the time allowed by the notice even in the absence of complete information.