The Validity of Restraints on Alienation in an Oil and Gas Lease

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INTRODUCTION

A new clause is starting to appear more frequently in oil and gas leases. This Article considers whether that clause is enforceable.

Landowners—when approached by companies about the possibility of an oil and gas lease—are more frequently requiring that the lease contain a restriction on the company's ability to transfer the lease rights to a third party.[1] By bargaining for this clause, landowners assume that they have prevented unwanted transfers of the lease interest. Whether they have achieved this desired result, however, is unclear under existing law.[2]

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1. *See* Mark K. Glasser & Scott Humphrey, *The Assignment of Oil and Gas Leases: Conditions, Constraints, and Consequences* § 4.01, at 120-21, *in* CTR. FOR AM. & INT'L LAW, SIXTY-SECOND ANNUAL INSTITUTE ON OIL AND GAS LAW (2011) ("As landmen, lawyers, and others involved in purchasing oil and gas leases are aware, today's landowners have become increasingly sophisticated with respect to the development of their mineral rights. More often than in years past, landowners today seek legal advice regarding the negotiation and enforcement of those rights. That advice commonly includes a recommendation that lessors endeavor to prohibit or restrict the transferability of leasehold interests."). Traditionally, the extractor's right to alienate the lease interest was expressly provided for in the lease. *See, e.g.*, RICHARD W. HEMINGWAY, THE LAW OF OIL AND GAS § 9.8 (3d ed. 1991) ("The oil and gas lease customarily provides that the interest of either the lessor or lessee may be assigned so long as it does not increase the burdens of the lessee.").

2. There is limited existing authority on this question. This limited authority is split. *Cf.* Outlaw v. Bowen, 285 S.W.2d 280, 283 (Tex. Civ. App. 1955) (holding that a restraint on the alienability of a fee simple absolute mineral interest is invalid, but not addressing or discussing the validity of a restraint on alienability

Whether these clauses should be enforced is a difficult question.[3] The difficulty derives from the sue generis nature of the oil and gas lease. An oil and gas lease accomplishes a task and creates a relationship that is unlike any other legal

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of a lease mineral interest). *Compare* Harding v. Viking Int'l Res. Co., 1 N.E.3d 872, 878 (Ohio Ct. App. 2013) (upholding a restraint on alienation), *and* HOWARD R. WILLIAMS & CHARLES J. MEYERS, OIL AND GAS LAW § 402 (Patrick H. Martin & Bruce M. Kramer, eds., 2014) (stating that restraints on alienation "appear generally to be sustained" and listing cases), *with* Shields v. Moffitt, 683 P.2d 530, 534 (Okla. 1984) (holding that a restriction on the lessee's ability to transfer the oil and gas lease was void as an illegal restraint on alienability).

3. The topic has received relatively little scholarly attention thus far. *See* Gary B. Conine, *Property Provisions of the Operating Agreement—Interpretation, Validity, and Enforceability*, 19 TEX. TECH. L. REV. 1263, 1380-81 (1988) (briefly discussing the issue and acknowledging that the rule against illegal restraints on alienability applies to the oil and gas context, but concluding that "[a]s long as the restraint is indirect and ancillary to a legitimate commercial purpose, it is likely that the restriction will survive the rule against restraint"); Glasser & Humphrey, *supra* note 1, § 4.02 at 130 (acknowledging that there are no Texas cases that directly address the question, but arguing that there is "little doubt that Texas courts will not enforce consent-to-assign clauses of any nature in the context of an oil and gas lease"); Robert E. Nowack, *Restrictions Against Alienation in Agreements Relating to Oil and Gas Interests*, 23 ALTA. L. REV. 62, 62-74 (1985) (discussing the issue under Canadian law); David E. Pierce, *An Analytical Approach to Drafting Assignments*, 44 SW. L.J. 943, 949-50 (1990) (briefly discussing the issue and offering suggestions for how to draft a transfer prohibition to increase the chances that it will be upheld and enforced); David Pierce, *Evaluating & Drafting Oil & Gas Lease Assignments*, 4 NAT'L ASS'N DIVISION ORD. ANALYSIS 385, 399-412 (1992) (acknowledging the legitimate reasons a landowner might want to restrict alienation of the oil and gas lease, but suggesting ways to achieve some of these objectives other than by an alienation restraint). Although all three Restatements of Property have devoted considerable attention to the legality of restraints on alienability, how this law applies in the context of an oil and gas lease has not been addressed. (The general topic of oil and gas has not been addressed in a restatement.) Most oil and gas hornbook writers skip over the issue entirely, often on the assumption that most oil and gas leases specifically permit—rather than restrict—transfers of the interest created. *See, e.g.*, HEMINGWAY, *supra* note 1, § 9.8 ("The oil and gas lease customarily provides that the interest of either the lessor or lessee may be assigned so long as it does not increase the burdens of the lessee."). This assumption seems to be less valid now than it was previously. *See* Glasser & Humphrey, *supra* note 1, § 4.01, at 120.

relationship.[4] This relationship straddles the line between "contract" and "property."[5]

But contract law and property law treat restrictions on transfers differently. Under contract law, a clause prohibiting the transfer of contractual duties will usually be enforced.[6] Under property law, however, the treatment of such a restriction—termed a "restraint on alienability"—is more nuanced.[7]

Every property lawyer knows that Uncle Scrooge cannot do the following in his will: "Blackacre to my nephew Huey, but he is not to sell the property." The restraint on Huey's ability to alienate his interest (a fee interest) in Blackacre is invalid and is thus stricken from the will. As a result, Huey gets Blackacre free of the restraint.

But property law is equally clear that a landlord *can* restrict a residential tenant from transferring a leasehold estate without the landlord's consent. Indeed, the law views this situation as so different than Scrooge's that in some jurisdictions a tenant must obtain the landlord's consent to alienate the leasehold interest *even if no clause in the contract prohibits the transfer*.[8]

All of the above labels—contract, fee, lease—are used by jurisdictions to describe the relationship between landowner and oil and gas producer. These labels, however, should not

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4. *See* Jennifer N. Cooper, *The Discovery Rule: Should Oil and Gas Leases Be Different?*, 38 HOUS. L. REV. 1283, 1300 (2001) ("Oil and gas leases are unique from other types of leases or contracts.").

5. *See* 2 EUGENE KUNTZ, A TREATISE ON THE LAW OF OIL AND GAS § 22.4(a) (1989) ("If the oil and gas lease were not a complex instrument, it would be possible to reach trustworthy conclusions by analogy to other areas of the law. If the lease could be classified as a conveyance of an interest in land and nothing else, it would be possible to invoke the law relating to . . . conveyances generally. If the lease could be classified as an executory contract and nothing else, it would be possible to invoke the law relating to . . . executory contracts.").

6. *See infra* notes 52-53 and accompanying text.

7. *See infra* pp. 318-19 and notes 39-42.

8. *See* Joshua Stein, *Assignment and Subletting Restrictions in Leases and What They Mean in the Real World*, 44 REAL PROP. TR. & EST. L.J. 1, 15 n.54 (2009) (listing state statutes).

be mechanically applied to resolve the validity of restraints in an oil and gas lease. The resolution to this question is too important for such a superficial analysis. Instead, the practical realities of the relationship created between the landowner and the oil and gas company should determine whether transfer restrictions should be upheld and enforced by the courts.

Ultimately, we conclude that alienation restraints in mineral leases should generally be enforced. Before proceeding, let us emphatically emphasize the scope of this conclusion. A company that wishes to develop minerals can always bargain for a clause that allows it to assign its interest. Such a clause would undoubtedly be enforceable.[9] And, a lease that is silent as to alienability would, by default, result in an alienable interest. The situation we address is different. Our situation is one where the landowner has expressly bargained for a clause that gives her the right to consent to future transfers of the extractor's interest. In this situation, the clause should be enforced. The extractor should not be able to agree to the clause, presumably pay less because of the restrictions imposed by the clause, and then avoid the clause as an unreasonable restraint on alienability.

The organization of this Article is as follows: Part I explains the necessity of ignoring labels when resolving whether alienation restraints within an oil and gas lease are enforceable. Part II examines the relationship between landowner and extractor. There, we attempt to describe the relationship created by a typical oil and gas lease without the use of labels. We do this to facilitate the analysis in Part III, where the underlying principles of alienability law are applied to this relationship. Part IV concludes by explaining why the enforcement of alienation restraints in the oil and gas context will not interfere with the functioning of the oil and gas industry.

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9. *See* RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS § 4.1, intro. note (AM. LAW INST. 1983).

I. THE PROBLEM WITH SUBSTITUTING LABELS FOR ANALYSIS

We begin with a plea to courts, lawyers, and commentators: avoid the temptation to resolve the validity of alienation restraints in an oil and gas lease by a simple resort to labels.[10] As we will explain in Part II, the nature of the relationship between landowner and extractor is unique.[11] As such, there is a natural tendency for judges, academics, and lawyers to borrow familiar terms and concepts when confronting disputes in this context.

The particular labels a jurisdiction has happened to apply to an oil and gas lease, however, should not determine the validity of an alienation restraint in an oil and gas lease. Courts use contract labels, property labels, or a mixture of the two when resolving disputes arising from an oil and gas lease.[12] Regardless of the terms used within a particular jurisdiction, however, the real-world relationship created between landowner and operator remains the same across jurisdictions. It is the nature of this relationship, rather than the labels a jurisdiction has happened to use in describing this relationship, that should govern the legality of alienation restraints in an oil and gas lease.

For the rest of this Article, we will abide with the plea made in this Part. The most common label applied to the relationship between landowner and extractor is the term "lease." Because the black-letter law almost always upholds

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10. Professors Martin and Kramer have termed this style of analysis as a "seemingly simple syllogistic logic." WILLIAMS & MEYERS, *supra* note 2, § 201.

11. *See infra* Part II.

12. *See, e.g.*, Egeland v. Cont'l Res., Inc., 616 N.W.2d 861, 864 (N.D. 2000) (stating that contract doctrines are applicable when interpreting a lease); Byron C. Keeling & Karolyn King Gillespie, *The First Marketable Product Doctrine: Just What Is the "Product"?*, 37 ST. MARY'S L.J. 1, 7 (2005) ("Most states have agreed that an oil and gas lease gives the lessee not only a contractual right to explore for oil and gas, but also an interest in property."); David E. Pierce, *Incorporating a Century of Oil and Gas Jurisprudence Into the "Modern" Oil and Gas Lease*, 33 WASHBURN L.J. 786, 792 n.21 (1994) (explaining that there are different ways to characterize the property interest involved in an oil and gas lease).

a landlord's restraint of a tenant's right to alienate,[13] it would be tempting to conclude that an oil and gas "lease" should automatically be controlled by this clearly-established law.

This type of superficial reliance on labels, however, would obscure the important policy considerations at stake. Granted, an oil and gas "lease" does share *some* common characteristics with the typical residential or commercial leases on which the law of landlord-tenant has arisen. It would distort reality, however, to suggest that an oil and gas "lease" was (1) identical to a landlord's lease of an apartment unit to a university student, and (2) that these two distinct relationships should be treated alike with regard to any legal issue that might arise.[14]

Thus, the ubiquitous use of the label "lease" to describe the relationship between landowner and extractor should not determine the validity of restraints on alienation in this context. Instead, it is the practical realities of this relationship that should control.

While the "lease" label suggests (superficially) that an oil and gas alienation restraint should be enforced, other labels might be used (superficially) to invalidate a restraint. This was the result in *Shields v. Moffitt*.[15] In *Shields*, the Oklahoma Supreme Court considered the validity of the following restraint in an oil and gas lease: "This lease may be assigned only with the written consent of the lessors."[16] Because this clause did not provide for any specific forfeiture remedy in the event of the tenant's attempted alienation (and because

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13. *See* RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS § 4.1, intro. note (AM. LAW INST. 1983).

14. *See* Nat. Gas Pipeline Co. Am. v. Pool, 124 S.W.3d 188, 192 (Tex. 2003) ("In Texas it has long been recognized that an oil and gas lease is not a 'lease' in the traditional sense of a lease of the surface of real property."); WILLIAMS & MEYERS, *supra* note 2, § 207 ("It is one thing, however, to use the label 'lease' as a shorthand expression which encompasses many aspects of the jural relationship of lessor and lessee and another to use the syllogism frequently employed by the courts and by advocates, *viz*, (1) a given right-duty or other relationship arises from a lease, (2) this is a lease, (3) therefore this right-duty or other relationship exists.").

15. Shields v. Moffitt, 683 P.2d 530 (Okla. 1984).

16. *Id.* at 531.

the clause obviously involved more than a mere contractual promise), the Court correctly determined that the clause was a disabling restraint.[17]

After correctly identifying the type of restraint involved in *Shields*, however, the Oklahoma Supreme Court rather mechanically applied the rule that disabling restraints are usually invalid.[18] To support this conclusion, the Court cited a previous Oklahoma Supreme Court case—*Lohmann v. Adams*[19]—that had applied the rule voiding disabling restraints on alienation.[20] The *Lohmann* case, however, did not involve an oil and gas lease.[21] Despite this, the *Shields* court made no attempt to determine whether this factual distinction mattered. In the *Shields* opinion, there is absolutely no discussion of why disabling restraints are usually invalidated and whether those reasons apply to an oil and gas lease.[22] As we

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17. *Id.* at 534 ("We likewise express no view herein as to what effect a forfeiture or penalty clause might have resulted had it accompanied the clause in the lease purporting to restrict right of sale without the consent of the plaintiffs/assignors.").

18. *Id.* ("We hold that the lease clause in the case at bar purporting to restrict alienation by the lessee of the oil and gas lease without the consent of the lessors is void and of no force or effect.").

19. Lohmann v. Adams, 540 P.2d 552 (Okla. 1975).

20. *Shields*, 683 P.2d at 534 (citing *Lohmann*, 540 P.2d at 557).

21. The *Lohmann* case did not even involve a land lease, let alone an oil and gas lease. *See Lohmann*, 540 P.2d at 553. The "rule" against disabling restraints on alienation does not usually apply to disabling restraints on a leasehold interest. *See* RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS § 4.1, intro. note (AM. LAW INST. 1983) ("The validity of . . . restraints on the tenant is generally recognized."); *id.* § 4.1 rep.'s note at 10 (discussing the modern trend in favor of enforcing disabling restraints in commercial transfers, particularly with regard to "leases in cooperative housing developments"). Thus, even outside the unique relationships created by an oil and gas lease, context matters in applying the traditional "rules" as to the validity of restraints on alienability.

22. *See generally Shields*, 683 P.2d 530. Even ignoring the oil and gas context involved in *Shields*, it is not entirely clear that the "rule" invalidating disabling restraints was applicable in that case. Although the restraint was properly characterized by the court as a disabling restraint, the court failed to consider that it was a *partial* disabling restraint rather than an *absolute* disabling restraint. The clause in *Shields* did not absolutely prohibit transfer, but prohibited transfer only without the landowner's consent. Under the "emerging rule," a landlord's refusal to give consent under this type of clause must be commercially reasonable. *See*

will show later in this Article, the reason that disabling restraints are usually invalid simply does not apply to the typical oil and gas lease.[23] Therefore, the *Shields* court's blind reliance on the "disabling restraint" label led the court to the wrong conclusion.

A similar result could occur in a jurisdiction using the "fee simple" label to describe the duration of the landowner-extractor relationship. For instance, under firmly-established Texas case law, an oil and gas lease creates a fee simple determinable estate in the lessee.[24] Because of the general presumption that restraints on a fee simple are usually invalid,[25] it would be tempting to conclude that a restraint on an extractor's interest under an oil and gas lease is invalid in Texas (or in any jurisdiction applying the "fee simple defeasible" label to an oil and gas lease). This conclusion, however, would elevate form over substance and eschew rigorous analysis for simple labels. As we will demonstrate later in this Article, the reason that restraints on fee simple estate are usually invalidated does not apply to the interest created in

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Thomas W. Merrill & Henry E. Smith, *The Property/Contract Interface*, 101 COLUM. L. REV. 773, 829 n.184 (2001) (describing the emerging view); *see also supra* note 3 (discussing case law on this issue). In this sense, then, a consent-to-transfer clause does not prohibit transfers to all third parties, even without the landlord's consent. The rule generally prohibiting disabling restraints does not apply with as much force to this type of partial restraint. *See* RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS § 4.1 (AM. LAW INST. 1983) (stating that a disabling restraint is invalid if it makes a transfer "impossible," but articulating a balancing test based on the "legal policy favoring freedom of alienation" if the disabling restraint does not make subsequent transfers impossible); *id.* at cmt. a ("An absolute and unbending rule of law is likely to carry down with it more than is necessary to achieve the objectives which led to the adoption of the rule in the first place. The [balancing test for disabling restraints that do not make a subsequent transfer impossible] is a recognition of this fact and upholds a disabling restraint in a limited area where justification for it may be found."). As discussed in the previous footnote, context matters in determining the validity of restraints on alienability.

23. *See infra* text accompanying notes 106-09.

24. *See* Texas Co. v. Daugherty, 176 S.W. 717, 722 (Tex. 1915).

25. *See* Glen O. Robinson, *Explaining Contingent Rights: The Puzzle of "Obsolete" Covenants*, 91 COLUM. L. REV. 546, 567 n.76 (1991) (stating the presumption).

the typical oil and gas lease.[26] As such, a court would err in supposing that this type of restraint is invalid simply because the label "fee" has sometimes been used by the courts to describe the duration of the interest created. The practical realities of an oil and gas lease—not labels—should determine the validity of restraints on alienability.

II. THE RELATIONSHIP BETWEEN LANDOWNER AND EXTRACTOR

When it comes to legal classification, an oil and gas lease is part contract and part conveyance.[27] Property law applies, but so does contract law. Labels from either branch of the common law are often harmlessly applied. But this Part avoids these labels. In fact, it avoids, to the extent possible, references to any sort of law at all. As explained above, these labels (harmlessly affixed in most other contexts), distract from the realities of the relationship between a mineral owner and her lessee. And these realities, not best-available labels, are what must drive Part III's attempt to apply alienability principles to this relationship.

When a person owns a piece of land, unless the minerals have been severed, she owns both the surface and the minerals (riches) that lie beneath. Let us evaluate from the perspective of a ranch owner. On the surface is the ranch house, the roads, the cattle, the tanks where the kids fish, the land where guests hunt, or perhaps just beautifully preserved aesthetics. Lying beneath is the oil. That oil can be turned into money. But the ranch owner cannot reach it with a shovel. Most people who own minerals are utterly incompetent to

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26. *See infra* Part III.B-D.

27. *See* KUNTZ, *supra* note 5, § 22.4(a) ("If the oil and gas lease were not a complex instrument, it would be possible to reach trustworthy conclusions by analogy to other areas of the law. If the lease could be classified as a conveyance of an interest in land and nothing else, it would be possible to invoke the law relating to . . . conveyances generally. If the lease could be classified as an executory contract and nothing else, it would be possible to invoke the law relating to . . . executory contracts.").

turn them into money.[28] They need someone who has the expertise and resources to extract the minerals;[29] the expert, in turn, needs a financial incentive to put his expertise to work.

Enter our oil extractor (whom we will later call a lessee).[30] The extractor can get the oil and wants to make a profit from getting it. Extracting the oil is a specialized task that involves significant initial investment and risk-tolerant long-term investment. The extractor will have to find the oil, far underground with heavy machinery. The extractor will then have to maintain personnel and machinery equipped to extract and transfer the oil—if and when it is located.

There is a match to be made here. The owner has oil that can be turned into money. The extractor says, "Hey, I can do that, but not for free." The normal (and sensible) arrangement starts by the owner agreeing to pay the extractor by letting the extractor have a portion of the oil if, and when, it is located. But the nature of the relationship that is to be created is far more complex, because this is not a treasure hunt performed with a shovel and ending with a quick retrieval of a box. Instead, it will take significant time to get to the oil. And the oil cannot be lifted to the surface all at once. It takes time. And for the arrangement to be worth it for both parties,

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28. Gary B. Conine, *Speculation, Prudent Operation, and the Economics of Oil and Gas Law*, 33 WASHBURN L.J. 670, 674 (1994) (stating that landowners rarely "have the technical or financial capability of conducting, or are willing to assume the risk of, such operations").

29. John S. Lowe, *Developments in Nonregulatory Oil and Gas Law*, *in* PROCEEDINGS OF THE THIRTY-NINTH ANNUAL INSTITUTE ON OIL AND GAS LAW AND TAXATION 1-1, 1-19 (Carol J. Holgren ed., 1988) ("[T]he lease transaction occurs because the owner of the mineral rights generally lacks the expertise and capital to develop them, and so transfers them to an oil company, which impliedly or expressly represents that it possesses the talent and the money to develop them.").

30. For simplicity, we will treat the lessee as the extractor. Although various arrangements may exist whereby the lessee may contract out various aspects of the extraction, those arrangements introduce verbiage and complexities irrelevant to this discussion. *See* Erica Levine Powers & Adam J. Yagelski, *The Oil and Gas Industry: Operations and Best Practices*, *in* BEYOND THE FRACKING WARS: A GUIDE FOR LAWYERS, PUBLIC OFFICIALS, PLANNERS, AND CITIZENS 19, 24 (Erica Levine Powers & Beth E. Kinne eds., 2013) ("The process of drilling a well can involve a complex relationship between an operator, OFS companies, and companies involved the midstream sector.").

that oil must be located and its stream of revenue extended for quite some time.

So the owner looks across the fields, roads, cattle, and whatever else makes the surface estate personal to the owner. And the owner needs to choose a partner to drill into this surface and to set up a continuing presence on the owner's property. Many terms and aspects of the relationship must be determined. Obviously, she must determine how, legally, they will give the extractor some of the minerals that belong to the owner. Given that the quantity of oil will never be known, she must decide how long the relationship will last. When will it end? How will the owner be paid? How will the owner know how much payment she is entitled to, given that the owner likely has no expertise in measuring oil quantities or other matters that would be required for an accounting? How much will extracting the minerals disrupt the surface estate?

The resulting relationship, however structured, will be enduring, dependent upon trust, and intimate in the sense of the extractor being an extended guest on the owner's property. The owner wants money, but likely not at all costs. As with any other cost-benefit equation, the owner's analysis will likely have limits as to when the costs of the extraction outweigh the benefits of the monthly check. Perhaps the owner is willing to enter into this relationship if the owner can trust the lessee to account accurately, to not unnecessarily disrupt the surface estate, to drive sensibly on the roads while the grandkids are playing, and to shut the gates so the cattle do not escape. On the other hand, most owners would not accept a monthly royalty check from a shady character they cannot trust to divvy up fairly and who will likely show insufficient attention to the disruption of activities on the surface.

The considerations of the extractor are almost entirely economic. This is not a bad thing—given the typical share-the-oil payment approach, the owner obviously benefits from the extractor wanting to produce sufficiently and efficiently. To the extractor, the intangibles of the surface estate are (understandably) merely a burden on efficiently extracting the minerals. Most extractors likely feel little sentiment about "ol' Catfish Pond." But they may have to accommodate that

pond or other owner requests, for the owner can decide that partnering with the extractor is just not worth it.

The parties could reach various arrangements. The owner could sell everything to the extractor, surface and minerals. The owner could *sell* the minerals to the extractor for a set price and be done with the minerals forever. Under either of these two arrangements, the extractor has assumed the inherent risks involved in mineral production: by purchasing the minerals, the extractor suffers the financial loss when a dry hole is drilled and the financial boon when a gusher is hit. The landowner, on the other hand, has insulated against these very risks by selling the minerals: she is no longer financially interested in the success of the drilling operators, because she has received her payment upfront.

The more typical arrangement—and the one with which this Article is concerned—is when the landowner forgoes an outright sale of the minerals in favor of a lease of the minerals. The incidents of this lease relationship are explored more directly below. As an initial matter, however, it is worth noting that a lease allocates the risk of mineral production differently than what occurs in an outright sale. If the extractor drills a dry hole, the landowner is not paid (or is paid a minimal amount). If the extractor hits a gusher, the landowner is paid handsomely. With a lease, the landowner's financial success depends on the success of the extractor. In a practical (but not a legal) sense, then, a lease creates a partnership between the landowner and extractor.

Under a lease, the owner has given up the owner's right to certain minerals that are extracted. But the owner still owns the surface.[31] The owner still has (in a non-legal sense) an interest in the minerals extracted because the owner will be paid from them. And the owner still has the right, in the future, to own the surface and minerals entirely again—once the lease ends. In the meantime, the owner's present inci-

31. *See* HEMINGWAY, *supra* note 1, § 1.3 ("When the mineral estate has been 'severed,' the remaining aggregate of rights in the land has become generically termed as the 'surface' [estate].").

dents of ownership must yield in order to effectuate the profitable removal of the minerals, lest both parties' expectations be thwarted.

In a legal sense, then, the owner maintains fee ownership of the surface estate, but must grant[32] certain permissions to use her property to effectuate the extraction. The owner does not *sell* the minerals absolutely; rather, the owner gives the extractor the right to extract the minerals for a certain period (often indefinitely), but then maintains a future interest in the mineral estate. And the details of the arrangement (Who pays whom? When? For how long? What about accountings? What are the restrictions on surface disruption?) will be governed by promises the parties make to each other. So long as this entire arrangement is worth it to the owner (who is considering all aspects of the arrangement) and sufficiently profitable for the extractor, the parties then partner up, using what is known as an oil and gas lease.[33]

III. APPLYING ALIENABILITY LAW TO OIL AND GAS LEASES

To determine the legality of alienation restraints in an oil and gas lease, it is not sufficient to understand the relationship between landowner and extractor (addressed in the previous Part); it is also necessary to have a basic understanding of the body of law that determines what restraints are enforceable and what restraints are illegal. In a separate article, we provide a more theoretical account of this body of

32. Even if the right to use the surface is not expressly granted to the extractor, this right is implied by the courts. *See* Harris v. Currie, 176 S.W.2d 302, 305 (Tex. 1943) (explaining the implied reservation to use the surface estate is necessary because "a grant or reservation of minerals would be wholly worthless if the grantee or reserver could not enter upon the land in order to explore for and extract the minerals granted . . ."); Bret Wells, *The Dominant Mineral Estate in the Horizontal Well Context: Time to Extend* Moser *Horizontally*, 53 HOUS. L. REV. 193 (2015).

33. For the remainder of this Article, and for ease of communication, we will employ the popular term "lease" to describe this relationship. As urged in Part I, however, the ultimate question addressed in this Article should not be resolved by resort to this convenient label.

law.[34] For present purposes, it is sufficient to discuss only the basic characteristics of this body of law.[35]

First, it is important to recognize that restraints on property interests[36] are sometimes upheld and sometimes invalidated. Despite the mantra in favor of the "free alienability of property" that is frequently recited in hornbooks,[37] casebooks,[38] and (occasionally) case opinions,[39] many types of privately-imposed restraints on alienability are upheld and enforced. Indeed, the most recent Restatement suggests that only "unreasonable" restraints should be invalidated.[40] This

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34. *See generally* Luke Meier & Rory Ryan, *Aggregate Alienability*, 60 VILL. L. REV. 1013 (2015).

35. A more thorough and detailed discussion of this law, and its underlying rationales, can be found in our *Aggregate Alienability* article. *See id.*

36. As mentioned previously, if no "property" interest is being conveyed, the relationship is controlled by contract law. The black-letter law discussed in this Part addresses "property" law. However, as explained in the text, the division between "property" and "contract" is often fuzzy, and the legality of restraints on property interests often considers how "contractual" the relationship between grantor and grantee is. *See supra* intro.

37. *See, e.g.*, CORNELIUS J. MOYNIHAN & SHELDON F. KURTZ, INTRODUCTION TO THE LAW OF REAL PROPERTY 42 (3d ed. 2002) ("[T]here is a very strong policy favoring the free and unfettered alienability of land.").

38. *See, e.g.*, JOHN P. DWYER & PETER S. MENELL, PROPERTY LAW AND POLICY: A COMPARATIVE INSTITUTIONAL PERSPECTIVE 184 (1998) ("Not surprisingly, given the struggle for free alienability of land, the common law developed a separate doctrine preventing 'direct' restraints on alienability."); THOMAS W. MERRILL & HENRY E. SMITH, PROPERTY: PRINCIPLES AND POLICIES 607 (2007) ("[O]ne of the normal incidents of owner sovereignty is transferability, and . . . courts consequently take a dim view of attempts to restrain the power of an owner to alienate. Thus, any attempt directly to restrain alienation will be held void as contrary to public policy.").

39. *See, e.g.*, Metro. Transp. Auth. v. Bruken Realty Corp., 492 N.E.2d 379, 381 (N.Y. 1986) ("Their purpose is to ensure the productive use and development of *property* by its current beneficial owners by simplifying ownership, facilitating exchange and *freeing property* from unknown or embarrassing impediments to *alienability*.") (emphasis added); Box L Corp. v. Teton Cty., 92 P.3d 811, 815 (Wyo. 2004) ("[T]he law favors the *free alienability* of *property* interests.") (emphasis added).

40. *See* RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.4 cmt. d (AM. LAW INST. 2000) ("A prohibition on transfer of property without the consent of another is an

mixed body of law (sometimes enforcing restraints and sometimes invalidating them) reflects the complexity of the issue. Although the common law prefers that property remain freely alienable,[41] the common law also assumes that parties should generally be able to dispose of their property as they wish.[42] When a grantor conveys Blackacre to a grantee but limits the grantee's ability to alienate Blackacre, these two fundamental concepts are in tension.[43] If the restraint is invalidated, the property remains freely alienable, but the grantor's right to dispose of his property according to his wishes is impaired. If, however, the restraint is upheld and enforced, the grantor's right to dispose of his property as he sees fit is respected, but at the cost of impairing the future alienability of the property.

This fundamental tension has resulted in a complex body of law that sometimes upholds the restraint on alienability and sometimes invalidates it. Thus, the resolution in any particular case will probably depend upon a variety of factors. The most important of these factors involve: (1) the type of transaction between grantor and grantee in which the re-

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unreasonable restraint on alienation unless there is a strong justification for the prohibition . . . .").

41. MERRILL & SMITH, *supra* note 38, at 532 ("The law has long favored transferability of property."); A. W. B. SIMPSON, AN INTRODUCTION TO THE HISTORY OF THE LAND LAW 224 (1961) (stating that the common law has attempted to preserve property alienability); Andrea J. Boyack, *Community Covenant Alienation Restraints and the Hazard of Unbounded Servitudes*, 42 REAL EST. L.J. 450, 452 (2014) ("Traditionally, the law has jealously guarded the right to transfer real property, striking down deed alienation restraints . . . .").

42. *See, e.g.*, JESSE DUKEMINIER ET AL., PROPERTY 102 n.3 (8th ed. 2014) (describing the "right to transfer" as one of the sticks in the bundle of property rights).

43. *See, e.g.*, MERRILL & SMITH, *supra* note 38, at 532 ("This rule [against restraints on alienation], of course, limits the freedom of the original owner to transfer: The original owner is barred from engaging in a transfer that limits further transfers."); *see also* EDWARD H. RABIN, FUNDAMENTALS OF MODERN PROPERTY LAW 257 (6th ed. 2011) (describing the tension between the proposition that a property owner should be able to sell his property as he sees fit with the notion that a property owner should be bound by a commitment not to refrain from selling the property).

straint is imposed (commercial transaction or probate conveyance); (2) the type of estate on which the restraint is imposed (fee simple, lease, etc.); and (3) the type of restraint involved (disabling or forfeiture).

In some instances, these factors have been reduced to common law "rules." Thus, for instance, a restraint imposed within a lease is generally enforceable,[44] while a restraint imposed upon a fee simple is generally not.[45] As implored in Part I, however, it is imperative to resist the temptation to resolve the legality of restraints in an oil and gas lease by a simple resort to labels.[46] Rather, it is important to understand *why* a restraint on a lease is often upheld and *why* a restraint on a fee simple is usually invalidated. Understanding the reasons for these "rules" is the key to applying them to a restraint imposed within the context of an oil and gas lease.

A. *An Oil and Gas Lease is an Inter Vivos, Commercial Transaction*

The common law regarding the validity of alienation restraints makes a distinction between restraints imposed within a donative transfer and those imposed within a non-donative transfer.[47] A donative transfer is a transfer in which

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44. *See* Alex M. Johnson, Jr., *Correctly Interpreting Long-Term Leases Pursuant to Modern Contract Law: Toward a Theory of Relational Leases*, 74 VA. L. REV. 751, 755 (1988) ("Historically, the common law courts, preferring form over function (as in much of property law), have not viewed the lease as a freehold estate, and have allowed absolute restrictions on the alienability of a lease.").

45. *See* Robinson, *supra* note 25, at 567 n.76 (stating the presumption).

46. In any event, these "rules" are overly broad and often contradictory. For instance, while one can find many cases invoking the "rule" that a restraint within a lease is valid, there are just as many cases reciting the rule that a disabling restraint is invalid. *Compare* Deviney v. Nationsbank, 993 S.W.2d 443, 452 (Tex. App. 1999) (one of many cases) *with* RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS § 4.1 statutory note (AM. LAW INST. 1983) (listing various "rules"). What, then, of a disabling restraint imposed upon a lease? Obviously, the various "rules" that are sometimes pronounced by courts or commentators are often more nuanced than what is suggested.

47. Both the Restatement (Second) of Property and the Restatement (Third) of Property address "donative transfers" as a separate topic. *See* RESTATEMENT (THIRD) OF PROP.: WILLS AND OTHER DONATIVE TRANSFERS intro. (AM. LAW INST.

the grantor receives no consideration for the conveyance.[48] A large percentage of donative transfers are probate transfers, meaning that the transfer occurs at the death of grantor; the rest are gifts made during the life of the grantor. Non-donative transfers, then, involve instances in which the grantee has paid consideration for the interest being transferred by the grantor. Therefore, we will refer to non-donative transfers as "commercial"[49] transfers.

Under the common law, a restraint imposed within a donative transfer is much more likely to be invalidated than a restraint imposed within a commercial transfer.[50] Stated

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1999) (explaining why donative transfers were not treated as separate topic); RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS intro. (AM. LAW INST. 1983) (same). The distinction between donative and non-donative transfers is also drawn in the initial Restatement, albeit in a more subtle fashion. *See* RESTATEMENT OF PROP. § 410 cmt. a (AM. LAW INST. 1944) (distinguishing the validity of a restraint on alienation of a lease when the restraint is imposed as part of a "business" transaction as opposed to another type of transaction such as a donative transfer).

48. *See* RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS intro. (AM. LAW INST. 1983) (explaining the difference between donative and non-donative transfers).

49. By "commercial," we simply intend to refer to any transaction that is not donative. Thus, any transaction in which the grantee is paying the grantor for the property interest being transferred is "commercial" for purposes of this Article. Thus, even if the grantee is buying the property for purposes of residential use of the property, the transaction is "commercial" in the sense that it is not donative.

50. The Restatement articulates this concept in a somewhat obtuse manner. *See* RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS intro. note (AM. LAW INST. 1983) ("[T]he rules developed in this Part [concerning donative transfers], to the extent that they permit restraints on alienation, are equally permissible in regard to non-donative transfers."). Despite the clumsiness of this language, however, the point that restraints on alienation are more likely to be valid in non-donative transfers is relatively clear. *See, e.g.*, Procter v. Foxmeyer Drug. Co., 884 S.W.2d 853, 858 (Tex. App. 1994) ("In other words, if an alleged restraint on alienation is valid under the Restatement provisions, it is valid whether the transaction is donative or nondonative. The important implication of the quoted passages, however, is that the Restatement was not intended to address *unreasonable* commercial restraints on alienation. That is, an alleged restraint on alienation could be *invalid* in a donative context, but nevertheless be *valid* in a nondonative context.") (emphasis in original); *see also* Restatement (SECOND) OF PROP.: DONATIVE TRANSFERS §4.1 cmt. d (AM. LAW INST. 1983) ("To the extent that a disabling restraint is found valid [in the context of a donative transfer], it should likewise be found valid in a non-donative transfer."); *id.* rep.'s note at 10 ("Recent

conversely, a restraint imposed within the context of a commercial transaction is much more likely to be upheld than a restraint imposed within a donative transfer.

Obviously, an oil and gas lease is not a donative transfer. The landowner does not convey to the extractor out of good will or pursuant to a donative spirit. Rather, the landowner enters into an oil and gas lease in the hopes of achieving monetary profit;[51] this, too, is the objective of the extractor. The financial arrangement between the landowner and extractor will usually include an upfront "bonus" at the commencement of the lease and "rent" in the form of royalty payments once successful production occurs.[52]

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developments in cases concerned with *commercial transfers* of property indicate that courts are increasingly willing to deal with disabling restraints on their individual merits rather than invalidating them wholesale, and will uphold such restraints if they leave available a means of current transfer and if under all the circumstances the legal policy favoring freedom of alienation does not reasonably apply.") (emphasis added). In addition, although the First and Third Restatements are less explicit than the Second Restatement in distinguishing between donative and non-donative transfers in their respective discussions of restraints on alienation, the analysis adopted in these Restatements nevertheless incorporates this distinction and confirms that the law is more permissive with regard to restraints on alienability for non-donative transfers. *See* RESTATEMENT OF PROP. § 410 cmt. a (AM. LAW INST. 1944) (stating that a restraint imposed as part of a "business transaction" is more likely to be valid as opposed to when the restraint is imposed as part of a donative transfer); *see also* RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.4 cmt. b (AM. LAW INST. 2000) (explaining that the validity of restraints imposed within a donative transfer is not separately addressed in the Third Restatement "because they are extensively treated in [the Second Restatement]"); *cf. id.* § 3.5 cmt. b (explaining that indirect restraints on alienation are more likely to be upheld when the restraints are imposed in a commercial transaction as opposed to a donative transfer).

51. As mentioned earlier, the landowner will often have other concerns that he wants to protect when entering the oil and gas lease (such as protecting the surface of his land during extraction). *See supra* pp. 315-17. Our point here, though, is that the reasons prompting a landowner to affirmatively enter into an oil and gas lease are financial.

52. *See* 3A NANCY SAINT-PAUL, SUMMERS OIL AND GAS § 30.1 (Thomson Reuters 3d ed. 2015) (explaining the cash bonus and royalty payments, as well as the delay rentals that may be paid in some jurisdictions so as to extend the lease even though actual drilling has not occurred). In some jurisdictions, royalty payments are not just the practical equivalent of rent, but are legally treated as rent, *see generally* O'Neal v. Union Producing Co., 153 F.2d 157 (5th Cir. 1946), thus entitling the landowner to cancellation of the lease when royalty payments are not

Moreover, an oil and gas lease, unlike most donative transfers, is not a probate transfer. The oil and gas lease is an inter vivos transaction, meaning that the conveyance by the landowner is made during the life of the landowner.

The inter vivos, commercial nature of the oil and gas lease would seem to point in favor of the enforcement of an alienation restraint within an oil and gas lease. These labels, however, are not determinative; rather, it is necessary to consider why restraints are more likely to be upheld *for* inter vivos, commercial transactions, and whether these reasons apply to an oil and gas lease.

1. Commercial v. Donative Transactions

The favorable treatment afforded alienation restraints imposed within a commercial transaction is related to the dual nature of such a transaction. When property is purchased (rather than donated), the *property* act of conveying the interest is part of a larger *contractual* relationship between the parties. Under this contractual relationship, the grantor must convey the bargained-for property interest while the grantee pays the bargained-for purchase price.

Because the property conveyance is part of a larger contractual agreement between the parties, it is natural that any restraint on alienation be considered from a contractual perspective as well as a property perspective. And viewing the relationship from a contractual perspective strongly favors the alienation restraint.

Contract doctrine generally holds that parties should be held to the bargain that they negotiate;[53] this assumption applies to restrictions within a contract against alienating the

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properly made. *See generally* Williams v. Humble Oil & Ref. Co., 432 F.2d 165 (5th Cir. 1970) (discussing the termination of a lease due to missed royalty payments).

53. *See* Danielle Kie Hart, *Contract Law Now—Reality Meets Legal Fictions*, 41 U. BALT. L. REV. 1, 1 (2011) ("Modern contract law is designed to achieve a fundamental objective, namely, to ensure that voluntary agreements between private parties are legally binding."). Of course, when there is "unequal bargaining" power between the parties, courts might refuse enforcement. *See, e.g.*, Daniel D. Barnhizer, *Inequality of Bargaining Power*, 76 U. COLO. L. REV. 139, 144-53 (2005)

subject matter of a contract.[54] Moreover, when part of that bargain is an alienation restraint, presumably the price that was commanded by the grantor was conditioned on the grantee's acceptance of that clause.[55] Allowing a grantee to agree to such a provision, and then later escape enforcement by arguing that the restriction is illegal, violates the basic contract precept that parties be held to their bargain.

Thus, the more contractual the relationship between grantor and grantee, the easier it is to view disputes between these two parties from a contractual relationship. And this contractual perspective weighs heavily in favor of enforcement of a privately-imposed restraint on alienability.

(explaining how inequalities in bargaining power factor into a variety of contract defenses). Under many of the usual methods for determining bargaining power, however, it is the oil and gas company—not the landowner—that would presumably have superior bargaining power. *See* Max Helveston & Michael Jacobs, *The Incoherent Role of Bargaining Power in Contract Law*, 49 WAKE FOREST L. REV. 1017, 1028-29 (2014) (discussing how some courts assume that a corporation with sophisticated knowledge of a subject matter will be presumed to have superior bargaining power). Thus, the concept of inequality of bargaining power is not a persuasive argument against enforcement of an alienation restraint. Rather, because enforcement would occur against the sophisticated oil and gas operator, consideration of the relative bargaining power of the parties would seem to further compel enforcement of the parties' bargain. *See* Ernest E. Smith, *Joint Operating Agreement Jurisprudence*, 33 WASHBURN L.J. 834, 839, 851 (1994) (stating that an operator is "almost invariably in a superior bargaining position" and that lessors might not have similar experience).

54. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 317(2)(c) (AM. LAW INST. 1981) (stating that contractual rights can usually be assigned, but acknowledging that a contractual restraint can change this result); *id.* § 322 (discussing enforcement of restraints on assignments of contractual rights); *id.* § 322 cmt. a ("In the absence of statute or other contrary public policy, the parties to a contract have power to limit the rights created by their agreement. The policy against restraints on the alienation of property has limited application to contractual rights."). In fact, there is a general presumption under contract law that personal duties under a contract cannot be delegated to a third party, even without a clause in the contract prohibiting this type of delegation. *See id.* § 319 cmt. b ("[P]erformance of personal services and the exercise of personal skill and discretion are not ordinarily delegable.").

55. *See, e.g.*, Alby v. Banc One Fin., 128 P.3d 81, 84 (Wash. 2006) ("However, the Brashlers' interest in free alienation is limited by the fact that they agreed to the restraint in consideration for the substantially reduced price. . . . Both parties also have legitimate interests in enforcing the terms of their contract.").

In a donative transfer, this contractual perspective is not appropriate. A grantee who receives a property interest pursuant to a donative transfer has not given *any* consideration for this interest. Thus, a donative transfer is 100% property and 0% contract.[56] The contractual argument in favor of enforcing the alienation restraint completely drops out of this type of transaction.

An oil and gas lease, however, is a quintessential commercial transaction. The entire arrangement is designed to secure economic profit for both the landowner and extractor. And, as has already been discussed above (and as will be discussed, again, below), the conveyance of the landowner's mineral interest is but a small part of the complex relationship created between landowner and extractor.[57] One look at a standard oil and gas lease—sometimes running into dozens of pages[58]—confirms the contractual nature of this "conveyance." Thus, a contractual perspective seems particularly appropriate when thinking about the relationship created by an oil and gas lease.[59]

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56. For this reason, both gift law and the law applicable to probate transfers are taught in law school "property" classes, not "contracts" classes. *See, e.g.*, JERRY L. ANDERSON & DANIEL B. BOGART, PROPERTY LAW: PRACTICE, PROBLEMS, AND PERSPECTIVES 255-58 (2014) (providing an introduction to wills); ERIC T. FREYFOGLE & BRADLEY C. KARKKAINEN, PROPERTY LAW: POWER, GOVERNANCE, AND THE COMMON GOOD 696 (2012) (dealing with transfers of property upon death); JOHN G. SPRANKLING & RAYMOND R. COLETTA, PROPERTY: A CONTEMPORARY APPROACH 208-30 (2d ed. 2012) (covering gifts of personal property).

57. *See* 2 SAINT-PAUL, *supra* note 52, § 13.2 ("And if the contract is viewed as a whole, it is different from an ordinary conveyance of land or of oil and gas in place, for it is these active duties of the lessee, created by express or implied covenants, which makes the interest created different from an ordinary conveyance of land or from the grant of a mineral fee in the oil and gas in place.").

58. S*ee* KUNTZ, *supra* note 5, § 18.1 ("The modern oil and gas lease is a very complex instrument which is the product of many years of rapid evolution. The length, as well as the complexity of the instrument, has increased considerably since the time of the first reported oil and gas lease.").

59. Indeed, some jurisdictions tend to view an oil and gas lease *solely* through a contract—rather than property—lens. *See, e.g.*, Harris v. Ohio Oil Co., 48 N.E. 502, 506 (Ohio 1897) ("The rights and remedies of the parties to an oil or gas lease must be determined by the terms of the written instrument, and the law applicable to one form of lease may not be, and generally is not, applicable to

Under this contractual perspective, the case for enforcement of the parties' bargain in an oil and gas lease is strong, particularly considering that enforcement of an alienation restraint will work against an oil and gas extractor. One would be hard-pressed to find a more sophisticated party than an oil and gas extractor.[60] Holding an oil and gas producer to the express terms of the deal it negotiated with a landowner is intuitive. Conversely, allowing a producer to escape enforcement of such a clause (after agreeing to such a clause when signing the lease) is objectionable.[61]

Besides the fact that a commercial transaction facilitates a contractual perspective of the relationship between the parties, a commercial transaction is also different than a donative transfer because the presence of a paying grantee ensures that society's broader concern in keeping property freely alienable is taken into account at the time the restraint is imposed. In a commercial transaction, the grantee paying for the property interest being conveyed is the same party who will be impaired by any alienation restraint. Thus, a grantee purchasing a property interest with an alienation restraint must determine whether the current transaction is

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another and different form. Such leases are contracts, and the terms of the contract with the law applicable to such terms must govern the rights and remedies of the parties."); KUNTZ, *supra* note 5, § 22.4 ("In Kansas, an unproductive oil and gas lease resembles an executory contract more than it does a conveyance of an interest in land.").

60. *Cf.* J. Zach Burt, *Playing the "Wild Card" in the High-Stakes Game of Urban Drilling: Unconscionability in the Early Barnett Shale Gas Leases*, 15 TEX. WESLEYAN L. REV. 1, 22 (2008) ("Because of the nature of the underlying business deal, and considering how the most common oil and gas lease is structured, a strong case for substantive unconscionability can already be made for early signers of Barnett Shale leases on these facts alone."); R.K. Pezold & Danny P. Richey, *The "Industry Deal" Among Oil and Gas Companies and the Federal Securities Acts*, 16 TEX. TECH. L. REV. 827, 870 (1985) ("Certainly, there is no reason for a sophisticated and experienced oil and gas company, which fails to bring that experience and sophistication to bear when considering whether to participate in drilling activity promoted by another oil and gas company, should thereafter be allowed to shield itself from its own folly and use the securities laws to rescind the transaction.").

61. This result is even more problematic if the extractor planned to ignore the restraint and, if necessary, argue that the restraint was illegal in subsequent litigation.

"worth it," given that the grantee might later be impaired in attempting to subsequently alienate the property. By nevertheless agreeing to purchase the interest (with the restraint attached), the grantee presumably decides that a purchase of the interest *now* is worth the *later* restriction on alienation.[62] The grantee's weighing process serves as a rough surrogate for the wider policy interests at play.[63]

In a donative transfer, however, there is no analogous weighing process by the grantee. Because the grantee is not paying for the property interest, any impairment on the grantee's ability to subsequently alienate the property will not change the grantee's cost-benefit analysis; the grantee has no costs in deciding to accept the property interest being donated.

This weighing process will definitely occur when the commercial transaction involves an oil and gas lease. An extractor who agrees to a lease containing an alienation restraint will almost surely analyze the benefits of buying the interest now with the risks of being unable to later alienate the interest. As explained above, this weighing process ensures that the costs of an alienation restraint are at least considered at the time of the transaction creating the alienation restraint. If anybody is likely to know the benefits of being able to freely alienate the oil and gas interest, it is the extractor. The decision of the extractor to proceed with the purchase of the interest (with the alienation restraint) means that the extractor believes that the benefits of immediate alienability[64] outweigh any future impairments on the ability of the extractor to transfer to a third party.

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62. Of course, the cost to a grantee purchasing an interest with an alienation restraint must be discounted by the probability that a court will not enforce the restraint (or that a landowner might waive the restraint).

63. *See* Meier & Ryan, *supra* note 34, at 1027 n.32.

64. These benefits are likely to be substantial, given that oil and gas production cannot usually commence unless a lease is signed. Here again, of course, an extractor will have to discount the costs associated with purchasing a restrained interest by the probability that a court (or the landowner) will later waive the restraint. *See supra* text accompanying note 62. In many states (most notably, Texas), because the law regarding the validity of alienation restraints in an oil and gas lease has not been firmly resolved, there are additional costs associated

2. Probate Transfers v. Inter Vivos Transfers

The large percentage of donative transfers that occur at death also explains why alienation restraints within a donative transfer are more likely to be stricken.

The law is particularly restrictive of restraints made within a probate transfer (through a will) because a probate grantor (a "devisor") *must* dispose of his property at death. As the old adage goes, "you can't take it with you." The devisor has no choice but to dispose of his property; if he refuses to do so through a will, it will pass by intestate succession to his heirs or escheat to the state.[65]

Because a probate transfer will occur even if a desired restraint is invalidated, the law is particularly likely to invalidate an alienation restraint in this context. By striking the restraint, the property remains freely alienable in the future. This is a benefit to invalidating the restraint. With a probate transfer, there is no cost to invalidating the restraint. Probate grantors cannot decide to forego a transaction simply because their desired restraint on alienability is likely to be declared illegal; they have no choice but to go through with a transfer of the property, even if some particular detail of the transaction (restraining alienability) might not be enforceable.[66] Death robs the grantor of any choice in the matter. Thus, there is no "chilling effect" on probate transfers that occurs from invalidating attempted alienation restraints.

With an inter vivos transaction, however, a grantor *does* have the ability to refrain from a transaction if she knows that her desired restraint on alienability will not be enforced by the courts. This represents a cost of enforcing a restraint; future grantors might decide to refrain from a transfer if they know their restraint on later transactions will be rejected by the courts.

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with this legal uncertainty. In this sense, then, there are benefits to resolving the issue which this Article addresses, regardless of the outcome reached by the courts.

65. *See* Hodel v. Irving, 481 U.S. 704, 727 (1987) (Stevens, J., concurring) ("At common law the property of a person who died intestate and without lawful heirs would escheat to the sovereign . . . .").

66. *See* Meier & Ryan, *supra* note 34, at 1026-27 n.30.

A landowner contemplating an oil and gas lease is, obviously, a living grantor. The landowner is alive, and is free to walk away if the arrangement is not on terms that are satisfactory to the landowner. A living landowner, unlike a probate donor, has this ability.

At first blush, it might seem far-fetched to suppose that a landowner might actually refrain from entering into an oil and gas lease if the landowner knows that he will have no ability to control who is conducting extracting operations on his land. Undoubtedly, there are some landowners who will nevertheless agree to an oil and gas lease, even if that landowner knows that her desire to restrain subsequent alienation of the interest to third parties will not be enforced.

But for some landowners (and landlords), the inability to control subsequent transfers of the exploration right will be a deal-breaker.[67] Here, it is important to consider the points made in the previous Section regarding the various values that will be important to a landowner in deciding whether—and with whom—to enter a lease. The landowner depends on the lessee to account accurately for profits, to sensibly share possession of the surface, and to otherwise act as a reasonable partner with the landowner. Because of this, *some* landowners, at least, will require control over whom they are partnering with.

The point here is not to resolve how frequently a landowner might make that decision. Rather, the important concepts are that (1) a landowner contemplating an oil and gas lease is a living person, and thus has the option to refrain from entering into an oil and gas lease, and (2) at least some landowners will refuse to enter into an oil and gas lease if they know the alienation restraint that they desire will not be enforced by the courts. These concepts (along with the points made above in Part III.A.1) explain why restraints on non-donative transfers are more likely to be upheld, and these concepts apply with full force to an oil and gas lease.

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67. The authors have first-hand experience with landowners having this perspective.

B. *An Oil and Gas Lease Involves an On-Going, Personal Relationship*

The common law maintains a sharp distinction between restraints imposed within a land lease and restraints imposed upon other types of property interests. In almost all instances, a landlord's restraint on a tenant's ability to alienate the lease will be enforced by the courts.[68] Moreover, in some states, *by operation of statutory law*, a tenant is precluded from transferring a lease to a third party without the landlord's consent.[69] Thus, even without an explicit clause in a lease prohibiting the tenant's transfer to a third party, the law will sometimes impair the tenant's ability to alienate the lease.

The rationale supporting land-lease restraints applies to a mineral lease. In fact, as explained below, these reasons apply with even *more* force to an oil and gas lease than they do to a land lease.

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68. *See* RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS § 4.1, intro. note (AM. LAW INST. 1989) ("Restraints on the alienation of tenants' interest in the landlord-tenant situation are widely used to give the landlord some additional assurance that the tenant of his choice will stay on the land and perform the obligations of the lease. The validity of these restraints on the tenant is generally recognized."); RESTATEMENT (SECOND) OF PROP.: LANDLORD AND TENANT § 15.2(2) (AM. LAW. INST. 1983) ("A restraint on alienation without the consent of the landlord of the tenant's interest in the leased property is valid . . . ."). It is common for leases to include a restraint on a tenant's right to alienate. *See* FREYFOGLE & KARKKAINEN, supra note 56, at 586 ("[M]any leases, both residential and commercial, provide that a tenant may not sublease or assign with the express consent of the landlord."). That the tenant's power to transfer the lease depends upon the landlord's consent does not alter the characterization of the restriction as an alienability restraint, because even a flat prohibition on alienation can be waived (that is, consented to) by the grantor. *See* RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.4 cmt. d ("A prohibition on transfer of property without the consent of another is an unreasonable restraint on alienation unless there is a strong justification for the prohibition . . . .").

69. *See* RESTATEMENT (SECOND) OF PROP.: LANDLORD AND TENANT § 15.1 (AM. LAW INST. 1977) (stating that a tenant is usually entitled to alienate his interest (absent a lease restraint on alienability), but providing exceptions); *see also* Stein, *supra* note 8, at 15 n.54 (listing states that preclude a tenant from alienating his interest unless consent to the transfer is given by the landlord, even without a lease provision requiring the landlord's consent).

A typical lease is unlike other transfers of possessory estates because it creates a continuing relationship between the grantor (the landlord) and the grantee (the tenant).[70] On the tenant's side is the continuing obligation to pay rent. The continuing obligation to make periodic payments to the landlord is different than the lump-sum, up-front payment involved in the conveyance of non-leasehold estate. Moreover, the tenant has the continuing duty to refrain from behavior that is disruptive to the land and improvements,[71] and in some instances the tenant might need to take affirmative steps to preserve the value of the land for the landlord.[72] The

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70. *See* WILLIAM B. STOEBUCK & DALE A. WHITMAN, THE LAW OF PROPERTY § 6.1 (3d ed. 2000) (defining a lease relationship in terms of the continuing covenants owed between landlord and tenant).

On this point, the argument made in this Section (that restraints in an oil and gas lease should be enforced because an oil and gas lease involves an on-going relationship) converges with an argument made in a previous Section (that restraints in an oil and gas lease should be enforced because the relationship is commercial and thus best viewed from a contractual perspective). The on-going relationship between landlord and tenant is best viewed through a contractual perspective, because the conveyance of the lease interest by landlord to tenant is but a small component of the transaction. That said, the argument made in this Section is analytically distinct from that advanced in the previous Section. A lease is a special type of commercial transaction in the sense that the contractual obligations between grantor and grantee are on-going for the life of the lease. Thus, while the case for enforcement of an alienability restraint is strong for any commercial transaction, the case for enforcement in a commercial transaction involving a lease is particularly strong because the contractual obligations of the parties are on-going. So, while the conveyance of a lease is part of a commercial transaction, and that factor alone is a reason to enforce the restraint (as discussed in Part III.A.1), the point made here is that a lease is a unique commercial transaction in that the respective obligations owed by the parties continue on throughout the "life" of the lease.

71. John A. Lovett, *Doctrines of Waste in a Landscape of Waste*, 72 MO. L. REV. 1209, 1212-20 (2007) (explaining how the law precludes a tenant from conduct amounting to affirmative waste). Often, the lease will explicitly address a tenant's duty in this regard, but even without such a lease provision the duty is imposed by the common law. *See* CALVIN MASSEY, PROPERTY LAW: PRINCIPLES, PROBLEMS, AND CASES 348 (2012) ("Leases commonly contain provisions that prohibit the tenant from committing waste of the premises . . . . In the absence of such provisions, though, tenants are still liable for waste that they may commit.").

72. *See generally* Anthony J. Fejfar, *Permissive Waste and the Warranty of Habitability in Residential Tenancies*, 31 CUMB. L. REV. 1 (2001) (considering

landlord, for his part, also owes a variety of continuing obligations to the tenant under standard "landlord-tenant" law.[73] The landlord, for instance, will usually be obligated to make repairs to the premises such that the purpose of the lease can be fulfilled.[74]

Often, both the landlord and tenant will attempt to define, in the lease, the respective duties of each party going forward.[75] This is why a lease is usually a longer, more involved document than is a deed for a non-leasehold estate. With a deed, the grantor and grantee know that they will each go their separate ways after closing.[76] With a lease, however, the parties understand that there will be a continuing relationship going forward, and clarity and understanding regarding the nature of this relationship is sought at the outset.

Because of the on-going, personal nature of the landlord-tenant relationship, the law allows surface landlords to preclude a tenant from substituting a new party into this rela-

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when a tenant might be required to take affirmative steps to prevent "permissive waste").

73. *See* DANIEL B. BOGART & CAROL NECOLE BROWN, PROPERTY LAW: WHAT MATTERS AND WHY 121-28 (2012) (explaining the historical shift resulting in more duties owed tenants by landlords).

74. *See* Nadav Shoked, *The Duty to Maintain*, 64 DUKE L.J. 437, 477 (2014) ("In addition to these explicit and voluntary promises, there are implicit covenants that courts or legislatures insert into all leases, regardless of the parties' desires. Many such legally created obligations impose on landlords assorted duties to maintain. These include a duty to maintain the building's common spaces in a safe condition and to protect tenants' premises from third parties' illegal activities.").

75. *See id.*

76. Of course, assuming that the grantor has given a warranty deed, a title defect might unite the parties. *See generally* Charles B. Sheppard, *Assurances of Titles to Real Property Available in the United States: Is a Person Who Assures a Quality of Title to Real Property Liable for a Defect in the Title Caused by Conduct of the Assured?*, 79 N.D. L. REV. 311, 313-26 (2003) (describing the title covenants made in a general or special warranty deed). This lawsuit, however, is different than the on-going (and non-litigious) relationship described in the text.

tionship without the landlord's approval, assuming the landlord has asserted a clause to this effect in the original lease.[77] It is quite sensible for a landlord to want to control who he is going to owe duties to (under landlord-tenant law) going forward, and who is going to owe him duties (specifically, the duty to pay rent)[78] going forward. Quite sensibly, then, the law enforces alienation restraints in the land lease context.[79]

The same concerns accompany a mineral lease. Like with a typical lease, there are multiple, continuing obligations involved; the signing of the lease is just the beginning of the relationship that is being commenced. Solely with regard to exploration and production, the on-going duties of the lessee (some of them expressly provided for in the lease and some of them implied), have been described as follows:

> To fully state the duties of the lessee, to be performed previous to the payment of all of the royalties which he may earn from the land, the lease would contain an express covenant to drill a test or discovery well within a fixed time, a covenant, if oil and gas are found in paying quantities, to drill a certain number of wells on the land within a stated time; a covenant to protect the demised land from drainage through wells on adjoining lands by drilling offset wells, stating with particularity the time, place, and manner of drilling such wells; and a covenant to market the product of the wells after production.[80]

This on-going relationship between landowner and extractor is further complicated by the fact that the extractor's duties will be performed *on the landowner's surface estate*. In

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77. Because the reasons for precluding transfers are so strong, in some states a lessee is prevented from transferring the lease by operation of law, that is, even without a lease clause restraining alienation. *See* Joshua Stein, *Assignment and Subletting Restrictions in Leases and What They Mean in the Real World*, 44 REAL PROP. TRUST & EST. J. 1, 20 n.54 (2009) (listing states).

78. *See* RESTATEMENT (SECOND) OF PROP.: LANDLORD AND TENANT § 15.2 cmt. a (AM. LAW. INST. 1977) ("The landlord may have an understandable concern about certain personal qualities of a tenant, particularly his reputation for meeting his financial obligations.").

79. *See* JOHN E. CRIBBET & CORWIN W. JOHNSON, PRINCIPLES OF THE LAW OF PROPERTY 274 (3d ed. 1989) ("The reasons for such restrictions [on alienability in a lease] are fairly apparent.").

80. 2 W.L. SUMMERS, THE LAW OF OIL AND GAS § 17.1 (3d ed. 2006).

a typical landlord-tenant relationship, possession of a particular piece of land is shared between the grantor and grantee across time. Thus, for instance, the tenant has the possessory rights to the residence on Blackacre for a particular time period, with the possessory rights to Blackacre reverting to the landlord after the expiration of the lease. This type of "sharing" of Blackacre—across time—is complicated enough, and requires that the parameters of this relationship be clearly spelled out at the outset of the lease. An oil and gas lease involves the same type of *durational* sharing of the *mineral estate*. In addition, though, there is a *concurrent* sharing of the *surface estate*. As explained in Part II, the landowner's valuable minerals can only be accessed through the surface estate. Thus, the extractor must be able to *use* the surface to remove the minerals;[81] but the landowner retains *ownership* of the surface, and likely has uses of the surface that he would like to see accommodated, if possible.[82]

This concurrent sharing of the surface estate thus makes the relationship between landowner and extractor even more intricate and interwoven than the typical relationship between landlord and tenant. To analogize, in a mineral lease it is as if the landowner has rented out only the *basement* of her house while retaining possession of the *ground floor*; moreover, the only way to access the basement is through the front door on the ground floor, which means that the tenant cannot even access the rented basement without using the landlord's front door and walking through the landlord's main floor to the stairs leading to the basement.

But there is more. One of the most important, on-going obligations in a standard land lease is the obligation of the tenant to pay rent. Because of the continuing rent obligation, the landlord has a legitimate interest in restricting transfers of the lease. Granted, a landlord always retains—theoretically, at least—the ability to pursue the original lessee if the

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81. *See* ERIC T. FREYFOGLE, NATURAL RESOURCES LAW: PRIVATE RIGHTS AND COLLECTIVE GOVERNANCE 395 (2007) ("The mineral lessee's rights are dominant to the extent that the lessee needs to use the surface for mining purpose, at least so long as the surface use is reasonably necessary.").

82. *See supra* text accompanying notes 26-30.

rent is not timely paid to the landlord, even if that original lessee has transferred the lease interest to a third party.[83] Practically speaking, however, the landlord would much prefer that the party in possession timely pay the rent.[84] The landlord has an assortment of remedies that are available against the possessing tenant that are not available against a party who is legally obligated to the landlord but is not in possession. For instance, the landlord can pursue a summary eviction against a possessing tenant;[85] a landlord might be able to lock-out the possessing tenant.[86]

This same interest applies in the oil and gas context, but it is much more acute. First, a landowner in an oil and gas lease (unlike a typical landlord) might not always have direct recourse against the original lessee after a transfer of the lease.[87] Second, the landowner must trust that the extractor is accounting accurately and honestly. The amount of "rent" the extractor owes the landowner will be determined by the

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83. *See* RESTATEMENT (SECOND) OF PROP.: LANDLORD AND TENANT § 16.1 cmt. c (AM. LAW INST. 1977) (making clear the continuing contractual liability of the original tenant absent a "release" or "novation").

84. *See* Gregory M. Stein, *Will Ticket Scalpers Meet the Same Fate as Spinal Tap Drummers? The Sale and Resale of Concert and Sports Tickets*, 42 PEPP. L. REV. 1, 28 (2014) ("Second, at least in the case of an assignment, the landlord nearly always receives the periodic rent directly from the new occupant of the property and is concerned about the particular occupant's ability to pay. Even in the case of a sublease, the primary tenant's ability to pay her rent to the landlord is likely to be impaired if she is not receiving the sublease rent from the subtenant."). The landlord's interest that the lease only be transferred to financially capable transferees can be generally viewed in terms of a practical interest in avoiding costly and time-consuming litigation.

85. *See* Mary B. Spector, *Tenants' Rights, Procedural Wrongs: The Summary Eviction and the Need for Reform*, 46 WAYNE L. REV. 135, 137 (2000) ("A summary proceeding for eviction exists in every state.").

86. *See* Adam B. Badawi, *Self-Help and the Rules of Engagement*, 29 YALE J. ON REG. 1, 24 (2012) (describing the circumstances under which landlord self-help is permitted in some jurisdictions).

87. It is common for the original lease to contain a "separate ownership" clause, which is intended to "absolve the original lessee from any liability if an assignee does not protect the leasehold from drainage, fails to pay royalty on production, or otherwise breaches express or implied lease covenants." ERNEST E. SMITH & JACQUELINE LANG WEAVER, TEXAS LAW OF OIL AND GAS § 5.4(C)(2) (Thomson Reuters 2014).

success of the exploration and drilling operations. The formula for calculating this "rent"—that is, royalty payments—will be established in the initial agreement.[88] The actual amount that is paid, however, depends on how much oil is extracted by the operator. The extractor—not the landowner—has access to the information that is necessary in determining the amount of royalty payments due the landowner.[89] In a very real sense, then, the landowner must trust that the extractor is honestly accounting to the landowner for his share of the production. Because of the necessary degree of trust placed in the extractor—and because of the opportunity of the extractor to take advantage of its superior access to information and to cheat the landowner out of his share of the proceeds[90]—it is quite sensible that a landowner be allowed to control transfers of the mineral interest.

Trust, however, is not the only component of the landowner-extractor relationship that affects the "rent" that is due the landowner. The *skill* of the extractor is also paramount. The amount that the landowner will be paid in royalties depends on the ability of an extractor to find oil and to bring it to the surface.[91] In a practical sense, then, the land-

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88. *See* Bruce M. Kramer, *Interpreting the Royalty Obligation by Looking at the Express Language: What a Novel Idea?*, 35 TEX. TECH. L. REV. 223, 224-33 (2004) (discussing the different types of royalty interests in current use and the history of these clauses).

89. *See* Ernest Smith, *Duties and Obligations Owed by An Operator To Nonoperators, Investors, and Other Interest Owners*, *in* 32 ROCKY MTN. MIN. L. INST. 12-1, 12-10 to -11 (1986) (stating that an operator has a fiduciary duty to account to the landowner that is typical of the duty placed on those with an obligation to "account for money or property received").

90. *Cf.* SMITH & WEAVER, *supra* note 87, § 4.6(E) ("Disputes between royalty owners and producers have existed since the early days of the oil and gas industries.").

91. WILLIAMS & MEYERS, *supra* note 2, § 601 (explaining the landowner's financial interest in quick exploration and production); Douglas R. Johnson, *The Cooperative Venture: Revisiting the Relationship Between the Royalty and Working Interest in Texas*, 5 TEX. WESLEYAN L. REV. 253, 253 (1999) ("If there is a large amount of oil or gas produced on the lease, the landowner will receive a large royalty; if there is a small amount of production, the royalty will be proportionally

owner and extractor have entered into a joint venture or partnership in which the financial success to both parties depends on the skill of the extractor.[92] And, of course, some extractors are more skilled than are others. Both Peyton Manning and Brian Hoyer are professional quarterbacks, and both throw footballs to receivers. Manning, however, does it much more successfully than does Hoyer. The Denver Broncos would not feel satisfied if Manning transferred his pass-throwing obligations to Hoyer. Similarly, a landowner who has entered into an agreement with an extractor, in which the extractor's skill in locating and extracting minerals is a basis of the agreement, will want to be able to preclude the extractor from transferring this interest to a less-skilled party. It seems natural that the law would permit the landowner to prevent this type of transfer.

C. *The Finite Nature of Oil and Gas Resources Necessarily Limits the Duration of a Restraint*

In the previous Section, the favorable treatment afforded alienation restraints in leases was explained in terms of the personal, and on-going, relationship between landlord and tenant. There is another principle—a broader one—that also explains why alienation restraints within leases are treated favorably: leases will usually last for a shorter time period than other possessory estates, particularly fee simple absolute estates.

The black-letter law holds that alienation restraints imposed upon shorter interests are much more likely to be permissible and enforced than restraints imposed upon longer

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smaller."). Indeed, cases have recognized that there is an implied covenant obligation for an extractor to use new technology when doing so maximizes production. *See* SMITH & WEAVER, *supra* note 90, § 5.4(C)(2).

92. This "partnership" is also evidenced by the fact that the landowner might lose his interest in the mineral estate if the producer delays production and the minerals are captured by a competitor. *See generally* Bruce M. Kramer & Owen L. Anderson, *The Rule of Capture—An Oil and Gas Perspective*, 35 ENVTL. L. 899 (2005) (discussing the historical development and the modern application of the rule of capture).

possessory estates.[93] Thus, for example, a restraint imposed upon a fee simple absolute estate is much more likely to be invalidated than a restraint upon a life estate.[94]

The reason for this distinction within the black-letter law is simple: a restraint upon a longer estate means that the restriction on subsequent transfers of the interest remains in place for a much longer time period. Thus, a restraint on the alienability of a fee simple absolute—if it were enforceable—would mean that the property would forever be precluded from transfer.[95] When an alienation restraint is imposed upon a shorter interest, however, enforcement of the restraint would mean only a limited temporal restriction on transfer of the property.

The law's more favorable treatment of restraints on "shorter" estates (such as a life estate) works in favor of the enforcement of alienation restraints on an oil and gas lease. Under a standard oil and gas lease, the interest given to an extractor by a landowner usually extends so long as production can occur in "paying quantities."[96] From a strictly theo-

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93. *See* RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.4 cmt. c (AM. LAW INST. 2000) ("Generally, greater restraints are justified on estates of lesser duration than on estates of longer duration . . . ."); RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS § 4.2 (AM. LAW INST. 1983) (permitting forfeiture restraints on a life estate but invalidating them on a fee simple estate); RESTATEMENT OF PROP. §§ 406, 409-10 (AM. LAW INST. 1944) (imposing a more lenient approach to the validity of restraints on alienation of a life estate and term of years than restraints on alienation of a fee simple).

94. DWYER & MENELL, *supra* note 38, at 185 (stating that restraints on a fee are usually invalid, that restraints on a life estate may be valid, and that restraints on "lesser interests" are usually valid).

95. Of course, some method of transfer at the death of the holder of the interest must occur. *See* Ryan & Meier, *supra* note 34, at 1033-34.

96. Most modern oil and gas leases involve a primary term of one to ten years, under which the lessor can extend the lease, other than by production, through the payment of delay rentals. *See* HEMINGWAY, *supra* note 1, § 6.2 (explaining the use and history of delay rentals during the primary term). After this primary term, however, the lease continues only so long as oil and gas is produced in paying quantities. *See* WILLIAMS & MEYERS, *supra* note 2, § 601.4 ("The habendum clause of virtually all contemporary leases provides for a short primary term of from one to ten years and provide that the lease may be preserved beyond the

retical standpoint, of course, this could be of infinite duration.[97] From a practical standpoint, however, the limited quantity of minerals owned by any particular landowner necessarily limits the duration of an oil and gas lease. Even the most productive wells eventually dry up. When this occurs, the extractor's interest extinguishes.

The limited duration of an oil and gas lease should not be obscured by the "fee simple" label that some jurisdictions use to describe an oil and gas lease.[98] The fee simple term is used only because the duration of a standard oil and gas lease—for so long as production occurs in paying quantities—does not correlate to the duration of any of the three types of leases recognized under the common law.[99] The use of term "fee simple" to describe the duration of an extractor's interest evokes

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expiration of the primary term 'so long thereafter' as oil or gas (or other specified minerals) is produced in paying quantities.").

97. For this reason, some jurisdictions apply the "fee simple" label to a lease. *See* WILLIAMS & MEYERS, *supra* note 2, § 207.

98. *See id.* ("[T]he deed-lease distinction is of little value in determining legal consequences . . . .").

99. It is the absence of a definite ending date in the lease, coupled with the fact that a landowner cannot cancel an existing lease, which compels the conclusion that, under the formal estates system within the common law of property, an oil and gas "lease" is not a leasehold estate but is instead a fee simple defeasible. Under the common law of property, three types of "non-freehold" lease estates are recognized: a term of years, a periodic tenancy, and a tenancy at will. A term of years is an estate with a fixed, ascertainable date. ("Lease to last until December 31, 2016.") An oil and gas lease cannot be a term of years because it does not last until a fixed, ascertainable date. A periodic tenancy is a lease that extends for consecutive periods (week-to-week, month-to-month, year-to-year, etc.) until either landlord or tenant gives an adequate notice of termination, which is done if notice equal to the period is given. The modern oil and gas lease cannot be considered a periodic tenancy; no period is defined in the lease. A tenancy at will is a lease that lasts only so long as either party desires the lease to continue. An oil and gas lease cannot be a tenancy at will, because the landowner is not free to cancel the lease so long as the extractor is producing in paying quantities. *See generally* JAMES CHARLES SMITH, THE GLANNON GUIDE TO PROPERTY 179-89 (3d ed. 2015) (describing the characteristics of a term of years, periodic tenancy, and tenancy at will).

Thus, from a duration perspective, none of the common law leasehold estates "fit" the duration of the modern oil and gas lease. In deference to the numerous clausus principle, which precludes courts from recognizing new property estates, a court that is committed to fitting the oil and gas lease into the common law estates

the image of a lasting estate extending for generations. The reality, however, is that a modern oil and gas lease is of a necessarily-limited duration. This reality—rather than the "fee simple" label[100]—is relevant in determining the validity of a restraint on alienation in an oil and gas lease.

D. *An Extractor Can Surrender Its Interest Back to the Landowner*

The black-letter law regarding the validity of alienation restraints can depend upon the type of restraint involved.[101] Here, again, understanding the reason that this distinction

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system must conclude that the extractor's interest is a fee simple defeasible rather than a leasehold estate. *Only* by characterizing the estate as a fee simple defeasible can a court recognize the ending date of the estate is the cessation of production in paying quantities rather than a fixed ascertainable date, the ending of a period, or the simple giving of notice by one party to the other.

100. It is worth noting that those jurisdictions that apply the "fee simple" label to an oil and gas lease acknowledge that it is a defeasible—rather than absolute—fee. And the usual rule that restraints on a fee simple absolute are usually invalid does not apply to a fee simple defeasible. *See, e.g.*, RESTATEMENT OF PROP. § 407 cmt. b (AM. LAW INST. 1944) (explaining—in a somewhat obtuse manner—that a restraint on alienability for a fee simple defeasible is more likely to be reasonable, and thus valid, than is an identical restraint on a fee simple absolute); *see also* RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.4 cmt. c (AM. LAW INST. 2000) ("Generally, greater restraints are justified on estates of lesser duration than on estates of longer duration . . . ."). We reject this sort of mechanical analysis in determining the validity of an alienation restraint in an oil and gas lease, but the distinctions we have developed in this Section between long and short estates is represented by the divergent treatment of alienation restraints for fee simple absolutes versus fee simple defeasibles.

101. *See* RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS §§ 3.1–.3 (AM. LAW INST. 1983); RESTATEMENT OF PROP. § 404 (AM. LAW INST. 1944) (making the distinction between disabling, forfeiture, and promissory restraints); ROGER BERNHARDT & ANN M. BURKHART, REAL PROPERTY IN A NUTSHELL 92 (6th ed. 2010) ("The legal effectiveness of [an alienation restraint] generally depends upon what type of restraint it is."). The Third Restatement eschews this distinction in favor of an all-encompassing balancing test of "reasonableness." *See* RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.4 (AM. LAW INST. 2000). Courts, however, continue to distinguish between disabling, forfeiture, and promissory restraints when determining the validity of an alienability restraint. *See, e.g.*, Vande Guchte v. Kort, 703 N.W.2d 611, 620-21 (Neb. Ct. App. 2005) (both recognizing this distinction in the context of determining the validity of an ability restraint); Alby v. Banc One Fin., 128 P.3d 81, 87 (Wash. 2006) (Chambers, J., dissenting).

is made within the common law furthers the conclusion that a restraint within an oil and gas lease should be enforced, even if it ostensibly resembles a disabling restraint.

There are basically three different types of alienation restraints. A disabling restraint is a restraint that purports to flatly prohibit or invalidate any subsequent transfer of the property.[102] A forfeiture restraint also restricts alienability but provides for a different remedy in the event of alienation; the interest is forfeited to either the original grantor (the person imposing the forfeiture restraint) or a third party.[103] A promissory restraint is conceptually different than the other two restraints in that its analytical foundations are rooted in contract law rather than property law. Under a promissory restraint, the grantee makes a promise that alienation will not occur.[104] If this promise is broken, the promisor-grantee is liable in contract damages to the promisee-grantor, but the transaction in violation of the promise is not affected.[105]

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102. *See* RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS § 3.1 (AM. LAW INST. 1983); RESTATEMENT OF PROP. § 404 (AM. LAW INST. 1944) (defining a disabling restraint).

103. *See* RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS § 3.2 (AM. LAW INST. 1983); RESTATEMENT OF PROP. § 404 (AM. LAW INST. 1944) (defining a forfeiture restraint). If the interest terminates in favor of the grantor, and assuming the forfeiture restraint is valid, the grantee has an interest that is either determinable or subject to a condition subsequent. If the interest terminates in favor of a third party, and assuming the forfeiture restraint is valid, the grantee has an interest that is subject to an executory limitation. *See* RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS § 3.2 cmt. b (AM. LAW INST. 1983) (using the word "special limitation" instead of determinable, but stating the concept).

104. *See* RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS § 3.3 (AM. LAW INST. 1983); RESTATEMENT OF PROP. § 404 (AM. LAW INST. 1944) (defining a promissory restraint).

105. This straightforward conclusion is muddled somewhat by the fact that contractual remedies can sometimes include specific performance in equity, and that courts have occasionally enforced promissory restraints by an injunction precluding the promisor from alienating the property. When this occurs, a promissory restraint functions in a manner similar to a disabling restraint. *See* RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS § 4.3 cmt. a (AM. LAW INST. 1983) (explaining that specific performance might be used to enforce a promissory restraint and the similarity in effect to a disabling restraint).

Both forfeiture and promissory restraints are much more likely to be enforced than is a disabling restraint.[106] In fact, disabling restraints are usually stricken, and one can find numerous cases stating this purported "rule."[107]

The reason that disabling restraints are usually invalidated is because of the dramatic affect a disabling restraint has on the general goal of free alienability. With a disabling restraint, the party who holds the restrained interest is flatly precluded from transferring the interest. The power of alienation has been withheld from the party; this "stick" in the property bundle of rights was never conveyed to the restrained party. This means that the restrained party is "stuck" with that interest; even if the party *wishes* to rid itself of that interest, there is no mechanism by which the party can achieve this objective.[108]

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106. The First Restatement is unequivocal in invalidating disabling restraints, while the Second Restatement is (slightly) more tolerant. *See* RESTATEMENT OF PROP. § 406(a) (AM. LAW INST. 1943) (stating that an alienability restraint is only valid if it is a forfeiture or promissory restraint); *see also* RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS § 4.1 (AM. LAW INST. 1983) (stating that a disabling restraint is invalid if, by its terms, it makes alienation impossible, but providing that disabling restraints that provide a process whereby alienation is possible (such as receiving the consent of a third party) can be valid in some circumstances); *id.* §§ 4.2–.3 (providing a balancing test for determining the validity of a forfeiture or promissory restraint).

107. *See, e.g.*, TransWorld Airlines, Inc. v. Am. Coupon Exch., Inc., 913 F.2d 676, 685 (9th Cir. 1990) ("The common law of property categorically condemns any disabling restraint . . . .").

108. When the grantee has no power to alienate, the interest held by the grantee passes to his or her heirs upon the grantee's death (assuming that the interest does not extinguish upon the grantee's death, such as with a life estate). *See* RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS, § 3.1 illus. 1 (AM. LAW INST. 1983) (implying that even the most "comprehensive as possible" alienability restraint must allow for transfer by intestate succession). The interest received by the heirs would still be impaired by the disabling restraint against alienation if the law did not invalidate this type of restraint. A disabling restraint, then, "freezes" alienation for the duration of the estate.

With a forfeiture or promissory restraint, however, there is *some* mechanism by which the restrained party can rid itself of the interest.[109] With a promissory restraint, the restrained party can transfer the interest but must pay contractual damages to the original grantor (promissee), to whom the promise not to alienate was made. With a forfeiture restraint, the restrained party can attempt to alienate the interest, with the result of that interest being forfeited, usually back to the original grantor. Thus, with either a promissory or forfeiture restraint, there is *some* mechanism by which the restrained party can rid itself of the unwanted interest. As such, there is not an absolute prohibition on transfer, but rather only a partial restraint on transfer; the particular parties to whom a transfer is made—and the consequences for doing so—are controlled by the initial forfeiture or promissory restraint, but a transfer of the interest is nevertheless possible.

The reasons that disabling restraints are usually invalidated does not apply to a restraint in an oil and gas lease, even if that restraint has been drafted as a disabling restraint. No restraint that is imposed on an extractor's mineral interest will ever function like a disabling restraint, such that the extractor is "stuck" with an unwanted interest. The extractor will always be able to surrender this interest back to the landowner. In almost all oil and gas leases, the extractor will have explicitly reserved the right to surrender the lease through a surrender clause.[110]

These explicit surrender clauses, however, only confirm the more basic truth that a court will almost always refuse to require a party to affirmatively perform duties to another party.[111] Recall that the agreement between landowner and

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109. *See Real Property—Direct Disabling Restraints on Alienation Annexed to Legal Life Estates*, 41 TENN. L. REV. 364, 365 (1974) ("[Forfeiture and promissory restraints] fare quite well in the courts and are most often upheld, since they do not substantially impair aliena[bility].").

110. *See* HEMINGWAY, *supra* note 1, § 7.9 ("Virtually all modern oil and gas lease forms contain a form of clause allowing the lessee to surrender the lease, or parts thereof.").

111. The practical difficulties associated with this type of remedy were nicely captured by Professor Dan Dobbs: "How do you make an opera singer sing her best? You don't." *See* DAN B. DOBBS, HANDBOOK ON THE LAW OF REMEDIES §§ 2.5, 12.2 (1973).

extractor is contractual in nature. The relationship between the parties does not end with the "conveyance" of the mineral interest from landowner to extractor. In reality, the relationship between these two parties is merely beginning at the time the mineral interest is conveyed to the extractor. Both parties, but particularly the extractor, have continuing obligations to one another under the relationship that is forged under the agreement. This type of relationship—like that of a landlord and tenant—is as much (if not more) a contractual relationship than it is a property relationship. The contractual nature of the relationship underscores the remedies that are available against a party who breaches a duty under the agreement. Under contract law, damages—rather than specific performance—is the normal sanction imposed on a party who breaks a promise.[112]

The reluctance of courts to remedy broken promises by specific performance means that an extractor who wants out of a lease can always achieve this result simply by breaking the promises the extractor made under the lease.[113] In other words, if an extractor truly wants to rid himself of the extraction right, all that needs to be done is to stop exploring or producing. The landowner will be entitled to any damages that he incurs because of the extractor's broken promise. But the extractor will not be forced, by court order, to continue to perform the duties associated with the mineral interest. Unlike what occurs with a disabling restraint,[114] an extractor

112. *See* 3 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS 162 (3d ed. 2004) (stating this basic proposition).

113. This concept should not be confused with the situation in which an extractor wants to *retain* the working interest of a lease while refraining from recovery operations. In this situation, a court might consider specific performance, but only under the assumption that failure to specifically perform will result in a *forfeiture* of the lease rather than *contempt* of court. *See, e.g.*, Fort Worth Nat'l Bank v. McLean, 245 S.W.2d 309, 310 (Tex. Ct. App. 1951) (considering whether to issue an order requiring exploration activities to avoid cancellation of a lease). Our point in this Section is that specific performance will never be ordered as a remedy for the operator who wants to repudiate an oil and gas lease and forfeit the interest therein; specific performance might, however, be ordered as an inducement to a party to perform a contract and avoid a subsequent forfeiture.

114. Although we conclude that disabling restraints in an oil and gas lease should be enforced, this conclusion should be distinguished from the advice we

who no longer wants the extraction interest will be able to achieve this result by simply walking away from the lease.[115] In this sense, then, enforcing a restraint on alienability will never produce the unfortunate situation in which a party is saddled with an unwanted interest.

IV. MINERAL OWNERS WHO DESIRE FULL ALIENABILITY RIGHTS CAN SECURE THEM IN THE LEASE

The reaction of the oil and gas industry to the arguments made in this Article can be easily predicted. Enforcing privately-imposed restraints on alienation, they will claim, will dramatically impair the functioning of the oil and gas markets. This argument, however, is erroneous.

First, we want to stress that we do not discount the importance of free alienability to the oil and gas industry. Undoubtedly, it is often convenient and efficient for these interests to be alienated from one firm to the other.[116] Particularly with regard to the dramatic fluctuations in oil and gas prices,[117] transfers of working interests under a lease might

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would give to landowners negotiating an oil and gas lease. We would never advise a landowner client to include a disabling restraint in an oil and gas lease. To the extent that a landowner intends to restrict the extractor's ability to alienate, he or she should draft the clause so as to provide for forfeiture in the event that the lessee alienates. Doing so strengthens the argument that the clause is valid and enforceable. Moreover, even if a disabling restraint is determined to be valid, some difficult issues arise in suits to enforce the clause, particularly when that suit is initiated by the original grantor in the transaction in which the disabling restraint was imposed. *See* Meier & Ryan, *supra* note 34, at 1036.

115. It is true that specific performance is sometimes ordered for contracts involving the conveyance of land, on the view that land is unique. But this general principle would not justify a court order requiring an extractor to commence or continue with extraction activities. The extractor's duties involve services rendered on the land, clearly distinguishable from the type of case in which courts sometimes order specific performance and require a party to convey an interest in land.

116. *See* SMITH & WEAVER, *supra* note 87, § 16.5(A) ("An assignment of a lease or an interest in a lease may occur as a result of farmout, a purchase agreement, an area-of-mutual-interest clause, or a variety of other types of contracts.").

117. *See* William D. Warren, *Transfer of the Oil and Gas Lessee's Interest*, 34 TEX. L. REV. 386, 386 (1956) ("No meaningful evaluation of the decisional trends in this field of law is possible unless it is realized that in the oil and gas

be desirable, for instance, when one company is purchased by a competitor. It might even be true that free alienability is more important to the oil and gas industry in particular than it is to the larger real property market.

Nothing that has been written in this Article, however, precludes extractors from securing the right to alienate the extraction rights secured by an oil and gas lease. We do not assert that the law does—or should—impose a general alienation restraint. The default rule, in the absence of a clause restraining alienation, is that any party may alienate their interest. Rather, our argument is simply that restraints on alienability, *when included as part of a bargained-for lease*, be enforced as written.

This distinction is critically important. If extractors want the right to transfer the interest in an oil and gas lease, they can bargain for a clause to that effect in the lease. Even if the lease is silent with regard to the extractor's alienation right, the general presumption in favor of alienability requires that the extractor be allowed to transfer that interest without the consent of the landowner. Moreover, even when a restraint *is* included in the lease, an extractor can always seek consent by the landowner to a transfer; a landowner undoubtedly has the ability to waive the alienability restraint. And a landowner who is unwilling to freely give consent might be persuaded to do so with a monetary offer.

In this sense, then, the conclusion that a restraint clause should be enforceable is merely a plea for symmetry in the types of arrangements that can be created by a landowner and an extractor. There is no doubt that an extractor can secure alienation rights by a lease clause to that effect; it seems

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production process the transfer of a lease is a normal, predictable event rather than the exceptional move it constitutes in other activities involving leases of interests relating to land. Why is this so? The petroleum exploration and development process is a popular one for financial speculation. An oil strike anywhere in the country is the signal for the onslaught of an army of professional oil-seekers. Of these legions the lease brokers, or, colloquially, the 'lease hounds,' are the shock troops, for their task is to obtain leases from landholders. Although some of them represent major producers, many are independent operators. Each lives and prospers by his native ability to induce the wary landowner to select him as the surest conduit to mineral riches. Their proficiency in persuasion is legendary. For purposes of the law of assignments the significant thing about their activities is that brokers usually lease land for purely speculative purposes.").

logical, then, that a landowner should be able to preclude alienation by a clause in the lease. Permitting one result, but not the other, limits the range of options that these *contracting parties* can agree to in pursuance of the development of the minerals.

If alienation restraints in oil and gas leases are not enforced, transfers of these interests will continue without due regard for the consequences of these transactions on the landowner. And, as illustrated herein, there can be significant negative effects on the landowner when these transactions occur. Allowing a landowner to bargain for restraints, and enforcing these restraints, ensures that the costs to the landowner are taken into account when these transfers are contemplated. In this sense, only desirable transfers will occur, considered from the perspective of *all* the parties who are affected by these transfers.