

Preferential Rights, Rights of First Refusal and Options: The Whys and Wherefores

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American Association of Petroleum Landmen
New Orleans, Louisiana
June 2000

I. The Preferential Right: An Introduction

A. The Preferential Right and Its Aliases

The term “preferential right” refers generally to a right to elect to purchase a property interest owned by another person upon the occurrence of a triggering event. As long as the triggering event does not occur, the holder of the right remains powerless. The time at which the holder must elect whether to exercise the right is thus not of his choosing.

In the oil and gas industry, the term usually refers to a right granted in a joint operating agreement (“JOA”) to purchase the mineral interest of another party to the JOA upon the party’s decision to sell that interest. The right becomes operative if, and only if, the owner of the property receives a bona fide offer for the sale of the property. *See Anderson v. Armour and Co.*, 473 P.2d 84 (Kan. 1970). The price and terms of the sale to the holder of the preferential right are determined by the offer from the third party: the seller must offer the interest for sale to the holder of the preferential right on the same terms that the proposed buyer proposes to pay. The holder of the preferential right will then have a given period of time to elect whether to purchase the interest or allow the sale to proceed. Upon the passage of the requisite period of time or the rejection of the option to buy by the holder of the preferential right, the sale may proceed to the proposed buyer. *See id.*

A number of terms are used interchangeably to refer to the preferential right mechanism. Perhaps the most common synonym, as suggested by the title of this presentation, is the “right of first refusal.” *See also Tenneco, Inc. v. Enterprise Prod. Co.*, 925 S.W.2d 640, 644 (Tex. 1996). Other nicknames include “option of first refusal,” “preemptive right,” “preemptive option,” “first option,” and “conditional or contingent right.” *See Producers Oil Co. v. Gore*, 610 P.2d 772, 773 (Okla. 1980); Terry I. Cross, *The Ties That Bind: Preemptive Rights and Restraints on Alienation That Commonly Burden Oil and Gas Properties*, 5 Tex. Wesleyan L. Rev. 193 (1999); Gary B. Conine, *Property Provisions of the Operating Agreement/Interpretation, Validity, and Enforceability*, 19 Tex. Tech. L. Rev. 1263, fn. 207 (1988). A key feature of a preferential right, moreover, is that the terms under which the right may be exercised lie within the exclusive control of the owner of the property subject to the right. *See Anderson*, 473 P.2d 84 (Kan. 1970). Indeed, the

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owner of the interest at issue may avoid the right entirely if he decides to hold on to the interest forever, or, more controversially, if the owner structures his transactions involving the interest carefully to avoid the preferential right clause in the JOA.

B. Why Would Anyone Grant a Preferential Right?

Cautious owners of mineral interests today avoid granting any unilateral preferential right without definite consideration for that right. Historically, however, various reasons have been cited as support for preferential rights schemes. First, a preferential right provides a modicum of security for its holder's investment in a well. Specifically, the right assures its holder that the risks it undertook in conducting exploratory operations will be rewarded, since it will be able to acquire additional interests in the lease in preference to third parties that did not undertake such risks. *See Questa Energy Corp. v. Vantage Point Energy, Inc.*, 887 S.W.2d 217, 222 (Tex.App.--Amarillo 1994, writ denied). In addition, a preferential right allows its holder to control whom his business partners will be in future lease operations. In particular, a preferential right will allow its holder to exclude a third party that lacks the financial wherewithal to bear its share of costs. A preferential right, moreover, will allow its holder to exclude a third party from the JOA that has an operational or engineering philosophy that differs from that of the current owners. *Id.*

Experience in the industry, however, has led some to criticize the reasons cited in favor of preferential rights clauses. Indeed, the inclusion of a preferential right in an operating agreement has several potentially negative implications that the contracting parties should consider prior to the agreement's execution. First, commentators have suggested that the preferential right has not been interpreted consistently to further the policies underlying the right. *See Conine, Property Provisions of the Operating Agreement/Interpretation, Validity, and Enforceability*, 19 Tex. Tech. L. Rev. at 1317. To the contrary, a preferential right may inject an element of unpredictability into an operating agreement, since the types of events that will trigger its exercise may be unclear.

Second, a preferential right may deter a potential buyer of an interest made the subject of the preemptive right. While the notice required by a preferential right is procedurally simple and the notice period may be extremely short, common sense dictates that a potential buyer will be reluctant to enter into extended negotiations to purchase the interest on beneficial terms when those terms may be used to coopt the deal for another party to the JOA. The potential for lost time and needless expense almost certainly impacts the market value of interests subject to these rights.

Third, a preferential right raises specific issues in the context of transactions involving multiple properties. Specifically, the fact that a right will often apply to some properties in a portfolio, while failing to appear in others, often causes confusion in "package" sales. In these cases, issues arise regarding the applicability of the sale price to specific properties, and careful attention must be paid to the closing date to ensure that the longest notice period of the preferential rights at issue is respected.

Fourth, the need for a preferential rights clause to ensure that any future interest owner has a compatible operating philosophy also has been criticized. Modern players in the oil and gas industry are, by and large, experienced producers with corporate philosophies designed to fully develop the potential of mineral reserves. Forced pooling, moreover, often removes the identity of parties to a JOA from the control of any given interest owner. *See Conine, Property Provisions of the Operating Agreement/Interpretation, Validity, and Enforceability*, 19 Tex. Tech. L. Rev. at 1317. It is thus likely that a party will already have entered into business arrangements relating to production from the lease with parties that are not of his choosing. While a preferential rights clause may allow

its holder to accumulate other interests in a lease and exert control over the identity of future JOA parties, he will probably have already reached arms-length agreements with the present parties. Under these circumstances, a preferential rights clause is of questionable benefit.

C. The Playing Field Today

As a result of the potential uncertainty surrounding such clauses, preferential rights clauses have encountered disfavor in recent years, and the clauses are now frequently deleted from the model form operating agreement. *See, e.g.*, Ernest E. Smith and Jacqueline Lang Weaver, Texas Law of Oil and Gas, Vol. 3, Issue 7, at p.389-1 (1996). When the clauses are included, the wording is often negotiated between the parties, and the rights granted are usually applicable to all parties to the JOA. It is rare that a preferential right will be granted without specific thought or negotiation between the parties regarding its terms.

However, many of the pitfalls traditionally afflicting preferential rights may be alleviated through careful drafting of the preferential rights clause and consideration of the potential transactions that will trigger the right in the future. By removing the legal uncertainties that accompany many of the form operating agreements, the parties may ensure that future operations will not be clouded by disagreements relating to the application of the clause. A party that perceives that the clause is to its benefit should, therefore, seriously consider its inclusion in any joint operating agreement that it enters.

II. The Option in the Context of Joint Operating Agreements

A preferential right is, technically, an option. *See, e.g., Weber v. Texas Co.*, 83 F.2d 807 (5th Cir. 1936). A true option, however, is conceptually different from a preferential right in ways that fundamentally affect the negotiation and drafting of agreements relating to each type of right. Most significantly, a true option to purchase a property interest allows the holder of the option to choose, at any time, to exercise the option. Specifically, for as long as the option is valid, the optionee possesses an absolute right to purchase the interest at issue at his or her whim. *See Anderson*, 473 P.2d 84. There is no requirement that the owner of the interest intend to sell the interest or that a third party offer to purchase the property. Legally, the option embodies the owner's irrevocable offer to sell the interest for the duration of the option term. The optionee may "accept" the interest owner's offer to purchase the interest at any time according to the terms specified in the document granting the option. *See Jeffery J. Scott, Restrictions on Alienation Applied to Oil and Gas Transactions*, 31 Rocky Mtn. Min. L. Inst. 15-1, 15-7 (1985). At the time the option is exercised, a binding contract of sale is created between the parties. *See id.* As a result, an option to purchase normally must arise from a contract that contains all of the terms of the proposed sale, including the sale price, in order to be enforceable. *See Anderson*, 473 P.2d 84.

III. Ties that Bind: The Impact of Preferential Rights and Options on Third Parties.

An option or right of first refusal will normally bind a purchaser of a mineral interest to the same extent that it bound the original owner of the interest. Specifically, both types of options are valid and continuing for the duration specified in the underlying agreement. The exercise of an option, as explained above, is within the control of optionee at all times. The holder of a preferential right, however, also holds on to his right for the duration of the operating agreement. Specifically, if

the holder of a preferential right allows a sale to a third party to proceed, the holder may nevertheless exercise the preferential right when the third party purchaser himself decides to sell the interest. *See Conine, Property Provisions of the Operating Agreement/Interpretation, Validity, and Enforceability*, 19 Tex. Tech. L. Rev. at 1323 (citing *Foster v. Bullard*, 496 S.W.2d 724, 736 (Tex.Civ.App./Austin 1973, writ ref'd n.r.e.)). The fact that the preferential right may not be exercised therefore has no extinguishing effect on the right. *See, e.g., Cherokee Water Co. v. Forderhouse*, 641 S.W.2d 522 (Tex. 1982) (preferential right is not waived as to later transactions when rightholder fails to exercise option in a prior transaction).

A purchaser of a mineral interest, moreover, may become the holder of a preferential right or option held by his or her predecessor-in-interest. Under normal circumstances, by purchasing a mineral interest whose owner holds a preferential right under a JOA, the purchaser becomes entitled to exercise the preferential right granted to his or her predecessor through the JOA. A party who is subject to a preferential right or option may thus find that the right or option is ultimately recognized by a person who was not an original party to the JOA.

In common law states, a preferential right or option normally will only benefit the purchaser of the interest of the preferential right holder or optioned if the interest at issue “runs with the land.” *Scott, Restrictions on Alienation Applied to Oil and Gas Transactions*, 31 Rocky Mtn. Min. L. Inst. at 15-10. Under this legal doctrine, a successor-in-interest to a property owner succeeds to all rights associated with the property that benefited the seller. The courts generally hold that a preferential right should be accorded this treatment because such rights meet the requirements for the an interest to run with the land: (1) the parties normally intend the right to apply to their successors-in-interest; (2) the successors-in-interest share privity of estate with their respective predecessors-in-interest (that is, the buyers normally purchase the interests for consideration and succeed to the sellers’ title); (3) the provision “touches” and “concerns” the land; and (4) both the burden and the benefit of the provision run to the parties’ successors-in-interest. *See Scott, Restrictions on Alienation Applied to Oil and Gas Transactions*, 31 Rocky Mtn. Min. L. Inst. at 15-10.

If a party granting a preferential right or option desires to limit that right to the grantee, rather than the grantee and his or her transferees, then special attention should be paid during the process of drafting the JOA. In that case, special effort should be made to specify that the option or right of first refusal is personal in nature to the grantee and/or limited in time. In addition, the option or preferential right should be reflected in a writing separate from the JOA in order to minimize the association of the option or right with the grantee’s mineral interest.

IV. Procedures and Issues Relating to the Exercise of Preferential Rights and Options Pertaining to Oil and Gas Interests

The procedure for exercising an option or preferential right varies according to the type of right at issue and the wording of the clause granting the right or option. In the case of an option, the optionor’s irrevocable offer of sale is accepted when the optionee delivers a notice of acceptance to the optionor. The notice cannot contradict the terms for the sale set out in the option agreement, and the notice cannot propose that the parties negotiate those terms. A binding contract of sale is created upon the delivery of the notice of acceptance to the optionee.

The exercise of a preferential right is more complex. Generally speaking, an owner of a mineral interest subject to a preferential right triggers that right by accepting, subject to the preferential right, an offer to purchase his or her interest from a third party. The exact nature of the transaction may determine whether or not the right is triggered. *See Part V, supra*. The moment at

which the right is triggered is often somewhat vague, however. While certain courts have stated that a preferential right is activated by the owner's decision to sell his interest according to a bona fide offer from a third party, other courts have described the triggering event as the formation of a specific intent by the owner of the interest to sell the interest for a definite price on definite terms. See Mark D. Christiansen, *Preferential Right of Purchase Issues in Oil and Gas Property Sales*, 35 Nat. Resources & Env't 32, 37 (1996) (citing *Capital Parks, Inc. v. Southeastern Adver. and Sales Sys., Inc.*, 30 F.3d 627, 629 (5th Cir. 1994), and *Sanchez v. Dickinson*, 551 S.W.2d 481, 486 (Tex.App.--San Antonio 1977, no writ), for the former holdings and citing *Henderson v. Nitschke*, 470 S.W.2d 410, 413 (Tex.App.--Eastland 1971, writ ref'd n.r.e.) for the latter statements).

Once a preferential rights clause has been activated, notice must be given, in writing, regarding the terms of the proposed sale and the identity of the proposed buyer. The notice must offer the holder of the preferential right the opportunity to purchase the interest of the seller on the same terms that the proposed purchaser has agreed to purchase the interest. See Conine, *Property Provisions of the Operating Agreement/Interpretation, Validity, and Enforceability*, 19 Tex. Tech. L. Rev. at 1323. At least one court requires that the notice be "reasonably definite" regarding the terms of the proposed sale. See *Koch Indus., Inc. v. Sun Co., Inc.*, 918 F.2d 1203, 1212 at fn. 6 (5th Cir. 1990) (applying Texas law). However, that same court stated that,

[w]e . . . emphasize the standard "reasonably," in contrast to a standard that would require an owner to satisfy every last one of the rightholder's requests for clarification of the offer even before the rightholder made such requests.

See id. The notice may not be subject to a caveat that the price or other terms remain the subject of negotiation between the seller and transferee. See Conine, *Property Provisions of the Operating Agreement/Interpretation, Validity, and Enforceability*, 19 Tex. Tech. L. Rev. at 1323. The holder of the preferential right must be provided with the amount of notice specified in the granting clause; the sale to the third party may not be closed prior to the rightholder's rejection of the offer to purchase or the running of the notice period.

The holder of a preferential right, following his or her receipt of notice of a proposed sale, possesses an option to purchase the property on the same terms. Conine, *Property Provisions of the Operating Agreement/Interpretation, Validity, and Enforceability*, 19 Tex. Tech. L. Rev. at 1323. The option expires according to the terms of the operating agreement at issue. *Id.* If notice is required forty-eight hours in advance of a closing, then the option expires forty-eight hours following the receipt of notice by the optionee. If the rightholder fails to exercise the option within that period, then he waives his preferential rights under the operating agreement. See *id.* at 1324 (citing *Ellis v. Waldrop*, 656 S.W.2d 902, 904 (Tex. 1983)). If the rightholder determines to exercise his preferential right, however, his or her acceptance must be unequivocal. See *id.* at 1323 (citing *Pinchin v. Kinney*, 623 S.W.2d 783, 785-86 (Tex.App./Austin 1981, no writ)). He or she may not alter the terms from those reflected in the notice; the rightholder may not, therefore, counteroffer to the seller without rejecting the option. See *id.* at 1323-24 (citing *Hutcherson v. Cronin*, 426 S.W.2d 638, 641 (Tex.Civ.App./Tyler 1968, no writ)).

In some cases, however, the rightholder's acceptance will be valid despite minor or insubstantial variations from the original offer. In these situations, some courts have recognized limited exceptions to the strict conformity requirements of the "unequivocal acceptance rule." See, e.g., *West Texas Transmission, L.P. v. Enron Corp.*, 907 F.2d 1554 (5th Cir. 1990). While the Fifth Circuit has not provided a hard and fast rule regarding what constitutes an insubstantial variation, it

appears that the court will invoke the exception when a seller imposes an offer upon a rightholder (1) that is commercially unreasonable, (2) that is offered in bad faith, or (3) that is specifically designed to defeat the preferential right. *Id.* at 1563. The Fifth Circuit’s opinion, moreover, elaborates that a variation will be insubstantial if either one or more terms of the offer reflect peculiarities in the relationship between the seller and the third party, or the unique terms of the third party’s offer are not reasonable bases to distinguish between that offer and the offer of the rightholder. The court reasoned that in the latter case, an attempt to distinguish between the third party’s offer and the rightholder’s offer will support an inference that the seller has imposed the terms in a bad-faith attempt to discourage the exercise of the preferential right. *See id.* at 1566.

Although the *West Texas Transmission* rule remains good law in the Fifth Circuit, it has been criticized as a poorly supported interpretation of Texas law. *See Cross, The Ties That Bind: Preemptive Rights and Restraints on Alienation That Commonly Burden Oil and Gas Properties*, 5 Tex. Wesleyan L. Rev. at 206-7. Texas courts appear to follow a slightly different and expanded formulation of the exception. For example, Texas courts will provide relief from the “universal acceptance rule” when the variation from the original offer is a result of fraud, surprise, accident, or mistake. *See Abraham Inv. Co. v. Payne Ranch, Inc.*, 968 S.W.2d 518, 527 (Tex.Civ.App. 1998) (citing *Jones v. Gibbs*, 130 S.W.2d 265, 271-73 (Tex. 1939)). As a result, Texas courts are more likely to grant relief to a rightholder for insubstantial variations from the original offer. Additionally, estoppel principles may provide relief to the rightholder when the offeror’s conduct prevents the offeree from properly making his acceptance. *See Abraham Inv.*, 968 S.W.2d at 527.

Additional issues may arise if the preferential right extends to multiple parties to an operating agreement. All of the parties to the JOA, in that case, would be entitled to the required notice. One or more of the right holders, moreover, could accept the offer to purchase the interest at stake. In such a case, the purchasers who accept the offer will divide the interest according to the proportion that the interest of each purchaser bears to total interest of all purchasing parties. *See Smith and Weaver, Texas Law of Oil and Gas, Vol. 3, Issue 7, at p.389-1.*

Similar to an option, moreover, a preferential right is insulated from events that affect the underlying sale. Specifically, following the rightholder’s receipt of notice of the proposed sale, the termination of the offer by the proposed buyer will not terminate the rightholder’s option to purchase the interest. *See Conine, Property Provisions of the Operating Agreement/Interpretation, Validity, and Enforceability*, 19 Tex. Tech. L. Rev. at 1323.

V. The Infamous “Triggering Event” for a Preferential Right

A. Introduction

A key factor in the operation of a preferential rights clause is the type of triggering event that will require its application. The exact type of event that will and will not activate preferential rights clauses has been the subject of extensive litigation, and a general consensus has emerged regarding the meaning of various terms that commonly appear in such clauses. In fact, the exemptions from preferential rights clauses have grown so numerous that the efficacy of such a clause must be seriously weighed before it is included, without revision or clarification, in any operating agreement. *See Conine, Property Provisions of the Operating Agreement/Interpretation, Validity, and Enforceability*, 19 Tex. Tech. L. Rev. at 1318. Some commentators, in fact, have suggested that courts today are unlikely to find that a preferential rights clause has been activated unless the interest subject to the right actually has been conveyed for consideration payable in cash. *See id.* at 1318.

Attempts by courts to interpret preferential rights clauses expansively have met with limited success. Some courts have purported to approach transfers from a practical perspective and held that the term “sale,” when used in a preferential rights clause, encompasses a transaction with the same effect as a sale. See Christiansen, *Preferential Right of Purchase Issues in Oil and Gas Property Sales*, 35 Nat. Resources & Env’t at 36 (citing *Galveston Terminals, Inc. v. Tenneco Oil Co.*, 904 S.W.2d 787, 791 (Tex.App.--Houston [1st Dist.] 1995, writ granted w.r.m.); *Cherokee Water*, 641 S.W.2d at 525; *Anderson*, 473 P.2d at 89). The Texas Supreme Court, however, has overruled at least one lower court’s practical approach to preferential rights issues. In that case, the court of appeals held that a transfer of real estate subject to a preferential right to a subsidiary, followed by the sale of stock of the subsidiary to a third party, violated the preferential rights agreement. See *Galveston Terminals*, 904 S.W.2d at 791. Specifically, the court looked to the intent of the parties and surrounding circumstances to determine the character of the transaction. See *id.* The Supreme Court later disapproved of the reasoning of the court of appeals, holding that preferential rights provisions should be interpreted narrowly in order to avoid undue restrictions on the transfer of stock. See *Tenneco, Inc.*, 925 S.W.2d at 646. The court held, moreover, that an interest owner’s characterization of a transfer as a sale of an asset in a press release, a federal tax return, or in negotiations is irrelevant to the impact of the transfer on a preferential rights agreement. See *id.* at 645. Courts, therefore, may not be relied upon to enforce a preferential rights clause simply because a party appears to have negated its operation through a circuitous transfer of a property interest.

This section’s discussion will investigate the courts’ treatment of various transactions that may affect a mineral interest subject to a preferential right. While the ultimate treatment of a given preferential right will depend upon the facts and language of the clause at issue, the following discussion will focus upon the most common disputes relating to transfers of mineral interests that are subject to preferential rights.

B. Gifts and bequests

Courts generally have rejected the application of a preferential right to an interest transferred through a gift or other action marked by donative intent. See Conine, *Property Provisions of the Operating Agreement/Interpretation, Validity, and Enforceability*, 19 Tex. Tech. L. Rev. at 1319 (citing *Perritt Co. v. Mitchell*, 663 S.W.2d 696 (Tex.App./Fort Worth 1983, writ ref’d n.r.e.)). The Montana Supreme Court, for example, has held that a gift of an interest subject to a preferential right to trusts benefiting relatives of the owner did not fall within the range of events contemplated by an operating agreement’s preferential rights clause. *Exeter Exploration Co. v. Fitzpatrick*, 661 P.2d 1255 (Mont. 1982). The Montana court concluded that the wording of clause, which applied “[i]n the event any party hereto desires to sell or assign any of its or his interest,” was not dispositive where other portions of the clause used the phrases “transfer and assign” or simply the term “assign.” See *id.* at 1259. In addition, the court noted that the converse position would be illogical: the clause was not intended to require an interest owner to offer her interest as a gift to the other parties to the JOA before she gave the interest to members of her family. See *id.* As a result, the court held that the clause was not intended to encompass transfers between family members for no consideration. See *id.*; see also *Draper v. Gochman*, 400 S.W.2d 545, 547 (Tex. 1966) (assuming that a gift or conveyance would be subject to a preferential right and would apply upon sale of property by grantee).

C. Involuntary transfers of the interest subject to the preferential right

The following types of transfers also have been concluded to fall outside the scope of preferential rights clauses:

1. Transfers by descent;
2. Public transfers by administrators;
3. Transfers as a result of condemnation;
4. Judicial sales.

See Conine, *Property Provisions of the Operating Agreement/Interpretation, Validity, and Enforceability*, 19 Tex. Tech. L. Rev. at 1318-19. As a result, these events normally do not activate preferential rights clauses.

In addition, a foreclosure on an interest subject to a preferential right may or may not activate the rightholder's ability to purchase the property. See *id.* at 1318-19. In at least one Texas case, for example, a preferential right has been held inapplicable to the foreclosure of a mortgage on a surface estate. See *Draper*, 400 S.W.2d 545 (holding that foreclosure did not reflect seller's "desire to sell," as the preferential rights clause required). The court took a narrow view of the mortgagor's intent in executing a deed of trust, holding that because the owner's intent was limited to a desire to borrow money, rather than a desire to sell the property, the preferential right remained dormant. See *id.* at 547. The court therefore treated the foreclosure as the other types of involuntary transfers have been treated. On the other hand, a Louisiana court has concluded that a preferential right may be exercised when the interest subject to that right is foreclosed upon. See *Price v. Town of Ruston*, 132 So. 653, 655-56 (La. 1931) (preferential right held applicable to sheriff's sale).

D. Transfers based on noncash consideration

Transfers for noncash consideration are often exempted from preemptive rights. See Conine, *Property Provisions of the Operating Agreement/Interpretation, Validity, and Enforceability*, 19 Tex. Tech. L. Rev. at 1319. One of the most common transfers to fall into this category is a transfer of a mineral interest in exchange for a third party's performance of a drilling obligation. See *id.* at 1319. A second type of transfer for noncash consideration is an exchange of properties, in which the owners of mineral interests swap their interests in a single transaction. See *id.* at 1319. However, not all exchanges of real property have been found to be exempt from preferential rights clauses. See *Anderson*, 473 P.2d 84. Specifically, in a case involving a lease of surface acreage, the Kansas Supreme Court found that a preferential rights clause was triggered by an exchange involving the lessor's ownership in the land. The court held that the fact that the consideration for the purchase involved cash as well as property was irrelevant. See *id.* Rather, the deed's language that the seller was to "bargain, sell and convey" the property to the purchaser signified that the clause was triggered by the transaction. See *id.*

E. The sale of an interest from a co-tenant to another co-tenant.

Sales of interests between mineral lessees have also been held to be excluded from preferential rights. *See Conine, Property Provisions of the Operating Agreement/Interpretation, Validity, and Enforceability*, 19 Tex. Tech. L. Rev. at 1319 (citing *Texas Co. v. Graf*, 221 S.W.2d 865 (Tex.Civ.App./Fort Worth 1949, writ ref'd n.r.e.) (holding that sale between cotenants was not intended to activate preferential right)). Such a sale arguably falls outside the policy concerns supporting the exercise of preferential rights, since a rightholder does not need to have the option to avoid entering into business with a third party in such a case.

F. Oil and gas leases by the true owners of minerals

Preferential rights sometimes appear in conveyances of real property, rather than operating agreements relating to oil and gas leases. Such cases have arisen, for example, in the context of transfers of surface acreage, in which the grantor has retained a mineral interest, subject to the grantee's right of first refusal upon the alienation of that interest. *See, e.g., Cherokee Water*, 641 S.W.2d 522. When the grantor chooses to enter into a mineral lease of his interest, an issue may arise regarding the preferential right of the grantee of the surface estate. *See id.* at 523. The Texas Supreme Court has held that because an oil and gas lease represents a grant of a fee simple determinable to the lessee, such that a transfer is a "sale" that will trigger a preferential rights clause. *See id.* at 525; *see also Sanchez*, 551 S.W.2d 481 (holding that mineral leases and mineral deeds reflected a sale of an interest in land that violated preferential rights clause applicable to surface acreage).

G. Overriding royalties

The only court that has apparently considered the issue ruled that a preferential right applied to an overriding royalty created subsequent to the execution of a JOA. *See Cross, The Ties That Bind: Preemptive Rights and Restraints on Alienation That Commonly Burden Oil and Gas Properties*, 5 Tex. Wesleyan L. Rev. at 197 (citing *IMCO Oil & Gas Co. v. Mitchell Energy Corp.*, 911 S.W.2d 916 (Tex.App.--Fort Worth 1995, no writ)). In that case, the sale of the overriding royalty by its owner activated the preferential rights of the other party to the JOA. *See IMCO Oil & Gas Co.*, 911 S.W.2d at 921. A party that anticipates that an overriding royalty may later be carved out of its interest may therefore wish to give extra thought to granting a preferential right to the other parties to the JOA. *But see id.* (noting that terms of operating agreement executed prior to creation of overriding royalty "expressly provided that any overriding royalty interest created by a party would be subject to the terms of the agreement").

H. Transfers of ownership in the corporation holding the interest

Changes in the ownership of corporations that hold mineral interests have been the subject of innumerable preferential rights disputes. Usually, the corporation is itself sold or the corporation transfers the interest to a subsidiary, which is then sold. Holders of preferential rights often feel cheated under these circumstances, since the ownership of the interest, while not conveyed to any party, has effectively changed hands to a third party.

A sale of stock in a corporate owner of a mineral interest does not comprise a triggering event under most preferential rights clauses. To the contrary, courts have repeatedly held that, absent an actual conveyance by the corporate owner, no transfer occurs that would trigger a

preferential right. *See Capital Parks*, 30 F.3d 627; *Tenneco, Inc.*, 925 S.W.2d at 645; *see also Fina Oil & Chemical Co. v. Amoco Prod.*, 673 So.2d 668 (La. App. 1st Cir. 1996) (holding that transfer of leases subject to preferential rights to subsidiary of party to JOA, and subsequent sale of subsidiary, did not trigger preferential rights); *Gamble v. Cornell Oil Co.*, 154 F.Supp. 581, 588 (W.D. Okla. 1957), *aff'd*, 260 F.2d 860 (10th Cir. 1958). Other types of transfers that are generally found to fall outside preferential rights clauses include the following:

1. A reorganization of the corporate owner of the interest. *See Smith and Weaver*, Texas Law of Oil and Gas, Vol. 3, Issue 7, at p.389-1.
2. A sale of all or substantially all of the assets of the corporate owner.

Any of these types of transfers, of course, may allow the ownership of a mineral interest to fall into the hands of a third party with whom a rightholder may not wish to do business. However, the courts have required, through these holdings, that specific language be included in a preferential rights agreement if the parties intend for these events to trigger the rightholder's option. *See, e.g., Tenneco, Inc.*, 925 S.W.2d at 646 (Tex. 1996) (refusing to imply a change-of-control provision where the parties could have included it in the operating agreement). Finally, it is important to note that these decisions have not invalidated the preferential rights at issue. Rather, the preferential right will apply to the new owner of the corporation that holds the interest, and the right will be triggered by a future transfer of the interest.

I. Package sales

Significant issues relating to the orderly administration of preferential rights often arise in context of transfers of multiple mineral interests. In many such transactions, a preferential rights agreement or a combination of such agreements will apply to only a portion of properties to be conveyed. Arguments have been made both for and against the activation of preferential rights clauses in the context of package sales. *See Cross, The Ties That Bind: Preemptive Rights and Restraints on Alienation That Commonly Burden Oil and Gas Properties*, 5 Tex. Wesleyan L. Rev. at 199-200 (concluding that the AAPL model operating agreement should be read to encompass package sales since no exclusion for such sales is stated within the form). When the sale contract fails to reflect any allocation of the purchase price among the interests to be transferred, however, the application of the preferential right becomes problematic. In addition, sale contracts that allocate a sum that does not reflect the market value of the interest subject to the preferential right also create serious questions regarding the application of any preferential rights.

Courts to consider package sales have approached the obligations of the owner of an interest sold in a package sale inconsistently. *See Conine, Property Provisions of the Operating Agreement/Interpretation, Validity, and Enforceability*, 19 Tex. Tech. L. Rev. at 1321. At least one court has held that in such a situation, the holder of the right must exercise it against all of the interests included in the sale. *See id.* (citing *First Nat'l Exchange Bank v. Roanoke Oil Co.*, 192 S.E. 764 (Va. 1937)). In that state, the rightholder may not choose the properties that he or she wishes to purchase selectively. In other states, the courts have reached the opposite result. Specifically, courts in California and Texas have held that rightholders may select the specific interests against which the right will be exercised. *See id.* (citing *Maron v. Howard*, (Cal. App. 1968); *Humphrey v. Wood*, 256 S.W.2d 669 (Tex.Civ.App.--Amarillo 1953, writ ref'd n.r.e.)).

Even in states in which a holder of a preferential right may be selective in exercising his option, package sales may have adverse effects that impact the value of the preferential right. These effects include:

- ! Confusion regarding the price attributable to the interest being sold;
- ! Unpredictability regarding the interests that will ultimately be sold to the potential purchaser; and
- ! Potential manipulation by the interest owner to avoid triggering the preferential right.

See Conine, Property Provisions of the Operating Agreement/Interpretation, Validity, and Enforceability, 19 Tex. Tech. L. Rev. at 1321-22. Often, to avoid these problems, the owner of an interest subject to a preferential right will request a waiver and release of the right by its holder prior to entering any purchase agreement. *See id.* at 1322. At least one commentator has suggested that this practice reflects the limited marketability that results from preferential rights. *See id.* Specifically, the need to individually consider a preferential right in a transaction involving multiple mineral interests will almost certainly deter potential purchasers from including that interest in a proposed transaction.²

VI. Drafting Issues Pertaining to Preferential Rights and Options

A. Model Wording

The preferential rights clauses that appear in model operating agreements are the result of countless hours of work by panels of oil and gas industry insiders, who have attempted to ensure that such clauses will predictably serve the interests of the contracting parties. As presented in this paper, the wording of these clauses often falls short of that goal. Suitable language, however, usually can be found by the parties to effectuate their intent. *See Conine, Property Provisions of the Operating Agreement/Interpretation, Validity, and Enforceability*, 19 Tex. Tech. L. Rev. at 1318.

² The application of a preferential right to a sale of a highly valued interest may also raise issues of federal law. *See Gary B. Conine, Property Provisions of the Operating Agreement/ Interpretation, Validity, and Enforceability*, 19 Tex. Tech. L. Rev. 1263, 1322 (1988). The Hart-Scott-Rodino Antitrust Act of 1976, in particular, provides a thirty-day waiting period for proposed sales by buyers or sellers who meet specific asset or net sales criteria. *See id.* (citing Act of Sept. 30, 1976, Pub. L. No. 94-435, 90 Stat. 1390 (1976)). The sales which trigger the act are those in excess of fifteen percent of the seller's assets or fifteen million dollars. *See id.* (citing 15 U.S.C. § 18(a) (1982); 16 C.F.R. §§800-03 (1987)). Significantly, sales of "realty in the ordinary course of business" are exempted from the notice requirements of the act, but certain federal agencies have refused to recognize producing oil and gas properties as exempt. *See id.* at 1322 (citing 15 U.S.C. § 18a(C)(1) (1982); 16 C.F.R. §802.1 (1987)). As a result, in those cases in which the rightholder is subject to the terms of the act, issues can arise regarding the rightholder's ability to exercise the right prior to a quick close of the sale between the seller and the proposed purchaser. *See id.* at 1322-23.

In drafting a preferential rights clause or option, the parties and their counsel must consider the goals of the parties in granting the right at issue and the potential variables that may affect the exercise of the right. In addition, a party drafting a preferential right clause should carefully consider the law of his or her state and the range of events that may affect the interest at issue. The price of working carelessly can be high: one court, for example, has held that even the term “assignment” was ambiguous in a clause that was to be triggered by the mere assignment of the interest at issue. *See id.* at 1318 (citing *Exeter Exploration Co.*, 661 P.2d at 1258-59).

The preferential right clause included in the current model form operating agreement of the AAPL provides as follows:

F. Preferential Right to Purchase:

(Optional; Check if applicable)

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

A.A.P.L. Form 610-1989. Several observations are in order regarding this language. First, this clause grants a preferential right not only as to the interests made the basis of the JOA, but also in each party’s other interests in the Contract Area. Second, the form is unclear regarding the exact event which requires notice of a proposed sale to be extended to the rightholder: the clause merely states that notice of a “proposed disposition” must be given should a party “desire to sell.” Third, at least one commentator has suggested that earlier versions of the model form were intended to endorse the type of smell-test approach to mineral interest transfers that some courts have enunciated. *See Christiansen, Preferential Right of Purchase Issues in Oil and Gas Property Sales*, 35 Nat. Resources & Env’t at 36. In particular, this form avoids the term “sale”, stating that a party must provide notice of the “proposed disposition” of the mineral interest at issue. Moreover, the fact that the form contains extensive language regarding transactions that fall outside its scope may be taken as an indicator that a range of events will fall within its provisions. *See id.* at 36.

B. Optional Provisions for Inclusion in Preferential Rights Clauses

Some farm-out agreements have restricted the preferential right to the period following the completion of the first well under the JOA. This limit allows the parties to the JOA to freely transfer their interests to third parties before the completion of the test well. Because the policies favoring preferential rights clauses would appear to apply equally during the period of initial operations as during later operations, the reasons for this type of clause are unclear. However, an example of this type of clause that has been cited in caselaw provides as follows:

After the completion of the well herein required to be drilled, should Operator desire to sell all or any part of its leasehold estates covered by this agreement, it will notify Owner as hereinabove provided of any bona fide offer that it has to sell such interest giving to Owner the interest it proposes to sell and the amount to be received for the interest to be sold and thereafter Owner shall have five (5) days in which to purchase the interest that Operator desires to sell at the price set forth in the notice given by Operator to Owner, and upon Owner's failure to immediately notify Operator after the expiration of five (5) days of its election to purchase said interest at the price proposed, then Operator shall be free to sell such interest. Nothing herein shall prevent Operator from selling any interest in the leasehold estate that it may see fit to do prior to the completion of the first well to anyone it sees fit to sell and at the price and terms it sees fit to sell, even though said assignment of such interest would not be executed and delivered prior to the completion of such first well.

See Panuco Oil Leases, Inc. v. Conroe Drilling Co., 202 F.Supp. 108 (S.D.Tex. 1961).

In addition, some lessees have sought to avoid the minefield of contradictory and unpredictable holdings relating to triggering events by expanding the language of clauses and explaining exactly what types of events should trigger the clauses' operation. Today, for example, a preferential rights clause is more likely to contain a description of the specific events that will trigger the clause's application, rather than a vague reference to any transfer of the underlying interest. *See Conine, Property Provisions of the Operating Agreement/Interpretation, Validity, and Enforceability*, 19 Tex. Tech. L. Rev. at 1320. Some clauses, moreover, specifically exclude transfers that result from a mortgage foreclosure, merger, reorganization, or consolidation of the interest owner, or a sale of all or substantially all of the assets of the interest owner. *See id.* at 1320 (citing *Draper*, 400 S.W.2d 545; *Torrey Delivery, Inc. v. Chautauqua Truck Sales, Inc.*, 366 N.Y.S.2d 506 (1975)). The AAPL model operating agreement contains this type of exclusion in the final sentence of its preferential rights clause.

Finally, a purchaser of a property subject to a preferential right should also keep in mind that it may be liable for breach of the preferential right at issue. As described in greater depth below, a purchaser has been held to share liability for failing to comply with the preferential rights clause with the seller of the property. *See Mobil Exploration & Prod. North America, Inc., v. Graham Royalty Ltd.*, 910 F.2d 504, 507 (8th Cir. 1990). As a result, a party that is purchasing an interest subject to a preferential right may also wish to include language relating to the preferential right in the contract of sale. The wisest course, naturally, would be the inclusion of an indemnity clause relating to the reimbursement of the costs of any legal dispute pertaining to the preferential right. A careful purchaser may also provide in the sale contract that the seller is responsible for notifying the holder of a preferential right of the sale. Such language might read as follows:

If the interest made the basis of this contract of sale is subject to a preferential right of purchase by a third party, Seller will obtain a waiver by the party of its preferential right in such form as will be timely supplied by Buyer. If Seller is unable to secure any such required waiver from a party holding a preferential right of purchase, Seller's title shall be deemed to be defective and this contract shall be null and void.

See Mobil, 910 F.2d at 507 (8th Cir. 1990) (citing similar language but holding that the purchaser and seller shared liability for breach of the preferential right at issue). In a package sale, moreover, the purchaser may wish to include a provision explicitly providing that the burden to determine which properties are subject to preferential rights or options lies with the seller.

C. A Drafting Pitfall: The Rule Against Perpetuities

Any party drafting a preferential rights clause, however, must approach its task with a careful eye toward the law of the forum state relating to future interests. Specifically, state courts differ regarding the application of the Rule Against Perpetuities (the "Rule") to preferential rights. The Rule, of course, represents the common law's attempt to prevent permanent restraints on the sale of property by voiding interests that do not "vest" within the required period.³ In states in which the Rule is applicable, it (traditionally) has voided any interest unless the interest "must vest, if at all, no later than twenty-one years after some life in being at the time of the creation of the interest" *Forderhouse*, 623 S.W.2d 435.

The Rule has been applied for centuries without regard to the facts before the courts: regardless of the likelihood that the Rule would actually be violated by the property interest at issue, the courts have applied it whenever a violation could hypothetically occur. Today, however, there are two views concerning the application of the Rule in the context of preferential rights in JOAs. One view applies the courts' traditional analysis of the Rule and invalidates any preferential right that is unlimited in duration. The other view, which has only emerged in recent decades, limits the application of the Rule to those cases in which its policies justify its application. In the view of the latter courts, the Rule is only a means of preventing unreasonable restraints on alienation, and if a preferential right does not actually operate to restrain alienation, then the agreement is not within the prohibition. As a result, in these courts, a preferential right that merely dictates who shall have the first right to acquire property when and if the owner desires to sell it is a permissible property interest.

The evolution of the Rule can be seen very clearly in the Fifth Circuit. The Fifth Circuit Court of Appeals determined at a relatively early date that the Rule should not invalidate a preferential right in the absence of perpetual interest of the type the Rule was designed to frustrate. *See Weber v. Texas Co.*, 83 F.2d at 808. Other courts have reasoned that an exception to the Rule exempted a future interest in a lease from the Rule's scope. *See Producers Oil*, 610 P.2d at 775. Because the interest owner may sell at any time and price that he or she wishes, moreover, the

³ As a creation of the common law, the Rule is inapplicable to Louisiana jurisprudence. Louisiana, however, has adopted a similar construct to the Rule in the Louisiana Civil Code.

policies underlying the rule against perpetuities are inapplicable. *See Weber v. Texas Co.*, 83 F.2d at 808.

Oklahoma's caselaw also demonstrates the evolution of the Rule's application to preferential rights. In *Melcher v. Camp*, for example, the Oklahoma Supreme Court held that an option to acquire an interest in property, whether based on a future event or limited to a specific duration, must be exercised within the period specified by the Rule. 435 P.2d 107 (Okla. 1967). An option that by its terms must not necessarily be exercised within that period or that is contingent upon an event that may not occur within the duration required by the Rule violates the Rule. *Id.* Such an option is void from its creation. *Id.* However, the Oklahoma Supreme Court later took a more benign view of preferential rights in the context of oil and gas leases. There, the court refused to invalidate a preferential rights clause, reasoning that the Rule should not apply. *See Producers Oil*, 610 P.2d at 775. The court relied, in part, on an exception to the Rule for interests in leases. *Id.* Specifically, the court stated that a preferential right to acquire an interest in an oil and gas lease is necessarily limited to the duration of the lease. *See id.* As a result, no future interest was created by the preferential right that could continue perpetually. *Id.* If the lease expires, neither party would have anything to convey. *Id.* The policies underlying the Rule thus were held inapplicable to the preferential right reflected in the JOA. The court, however, strongly hinted that a preferential right that includes a mechanism to set the purchase price for the interest may be more analogous to an option, and therefore it would be more likely to be invalidated under the Rule. *See id.* at 774.

Oklahoma's exception to the Rule for preferential rights in JOAs has been adopted in a number of other states, including, most recently, Mississippi. *See Forderhouse*, 623 S.W.2d 435;⁴ *Murphy Exploration & Prod. v. Sun Operating Ltd. Partnership*, 747 So.2d 260 (Miss. 1999). As a general rule in these states, a preferential right to purchase a share of a mineral right does not violate the Rule Against Perpetuities. However, an absolute option probably will violate the Rule. The distinction which courts have made between the preferential right and the absolute option is that the preferential right does not create an unreasonable restraint on alienation. *See Forderhouse*, 623 S.W.2d at 438; *Murphy*, 747 So.2d at 263. Typically, these courts have reasoned that the owner of an interest subject to a preferential right has the power to control when and if he will sell his interest; the preferential right does not, therefore, restrain the owner's ability to sell the mineral interest. *See id.* The preferential right holder only has the right to purchase when the owner decides to sell and, importantly, the owner can never be forced to sell. *See id.* Additionally, because there is no fixed price, the rightholder may only acquire the right by meeting any bona fide offer. *See id.*

Other states, however, continue to apply the Rule with its traditional force and hold that a preferential right unlimited in time violates the Rule. *See, e.g., Forderhouse v. Cherokee Water Co.*, 623 S.W.2d at 438 (citing *Robroy Land Co., Inc. v. Prather*, 601 P.2d 992 (Wash.App. 1979); 348 N.E.2d 306 (Ill. App. 1976); *Atchison v. City of Englewood*, 463 P.2d 297 (Colo. 1969); *Melcher v. Camp*, 435 P.2d 107 (Okla. 1967); *Neustadt v. Pearce*, 143 A.2d 437 (Conn. 1958)). The rule may thus invalidate contingent interests, including preferential rights, in oil and gas leases, royalties, and other mineral interests in these states. *See Scott, Restrictions on Alienation Applied to Oil and Gas*

⁴ The Texas Supreme Court eventually reviewed this case and overturned a portion of the appellate court's decision. *See Cherokee Water Co. v. Forderhouse*, 641 S.W.2d 522 (Tex. 1982). However, the Supreme Court clearly approved of the appellate court's decision and analysis regarding options and preferential rights under the Rule Against Perpetuities. *Id.*

Transactions, 31 Rocky Mtn. Min. L. Inst. at 15-11 (citing Restatement of the Law of Property 413 (1944)).

VI. Remedies for Violation of a Preferential Right or Options Clause and Potential Defenses

A. A Holder of a Preferential Right Has a Variety of Remedies Available to Him or Her

The holder of a preferential right has a choice of remedies upon discovering that his or her preferential right has been breached. Generally, upon the occurrence of a transfer or event that triggers the applicability of the preferential right, the holder of a preferential right may compel the optionor to comply with the terms of the contract or JOA and deliver the mineral interest to the rightholder. The holder of a preferential right has no power to force the owner of the interest at issue to sell the interest unless and until the triggering event occurs.

In addition, if a transfer that triggers a preferential rights clause is completed without notice to the holder of the preferential right, the original owner of the interest subject to the preferential right may be held liable to the rightholder for any damages. *See Mobil Exploration*, 910 F.2d 504 (8th Cir. 1990)(applying Arkansas law). Specific performance, however, may also be awarded. *See id.* at 507; *see also Duke v. Whatley*, 580 So.2d 1267, 1272 (Miss. 1991). If specific performance is awarded, the seller of the property or the purchaser of the property may be forced to convey the property to the rightholder.

A potential purchaser of an interest subject to a preferential right also should be aware that he or she may be implicated legally for the seller's failure to comply with its preferential right obligation. *See Mobil Exploration*, 910 F.2d at 507. In *Mobil*, for example, a party to a JOA that included a preferential rights clause sold its interest under the JOA as part of a package sale. *See id.* at 506. The buyer was given the opportunity to examine the JOA and related documents prior to the sale, but the buyer later argued that it could not be held liable for the seller's failure to comply with the preferential rights clause because it was not a party to the JOA. *See id.* at 507. The Eight Circuit Court of Appeals, however, disagreed and held that the purchaser of the property was liable because the assignment agreement subjected the buyer to the terms of the JOA. *Id.* As a result, since the purchaser should have known about the clause from documents forming the mineral interest's chain of title, the purchaser's lack of actual knowledge of the preferential rights clause prior to the sale could not shelter it from liability. Both the seller and the buyer were thus liable to the holder of the preferential right. *Id.* The purchaser of the property interest may thus be held liable for the profits from production following the time at which the mineral interest should have been conveyed to the rightholder. *See id.* at 504.

B. Waiver/Laches

Various affirmative defenses are available to persons who must defend against delayed assertions of preferential rights by rightholders. Laches, for example, may prevent an award of relief for denial of a preferential right under some circumstances. In the context of preferential rights, a court generally will find that laches applies when a party has waited an "unreasonable" amount of time to assert its rights, and the owner of the property has changed his position such that enforcement of the preferential right would be inequitable. *See Mobil*, 910 F.2d at 507 (applying Arkansas law). As a result, relief will be denied to the holder of the preferential right, even though

the owner of the mineral interest negligently failed to comply with that right at the time the interest was transferred. *Id.*

A court may also entertain an affirmative defense of waiver. A party will generally be found to have waived a legal or contractual right when the party knows about the right and intentionally relinquishes it or engages in conduct that is inconsistent with the right. *Tenneco, Inc.*, 925 S.W.2d at 643. Once the right is known to a party, silence or inaction may be used to support a claim of waiver. *Id.* In a case in which the parties to an operating agreement waited three years to assert a preferential right to another party's interest in a natural gas fractionation plant, for example, and treated the successor to that interest as a co-owner of the plant, the Texas Supreme Court has held that the other owners waived their preferential right. *Id.*

C. Estoppel

A rightholder risks being estopped from exercising her preferential right if she does not use diligence in exercising her right. As the courts have repeatedly held, any delay that prejudices or injures the proposed purchaser may be used to prevent the operation of the preferential right. *See Conine, Property Provisions of the Operating Agreement/Interpretation, Validity, and Enforceability*, 19 Tex. Tech. L. Rev. at 1324 (citing *Marken v. Goodall*, 478 F.2d 1052, 1054-55 (10th Cir. 1973); *Aldridge & Stroud, Inc. v. American-Canadian Oil & Drilling Corp.*, 357 S.W.2d 8, 11 (Ark. 1962); *Hartnett v. Jones*, 629 P.2d 1357, 1364 (Wyo. 1981)). Estoppel generally will prevent a recovery by a holder of a preferential right if the defendant proves that he relied in good faith on some action by holder of the preferential right and changed his position to his detriment. *See Mobil Exploration*, 910 F.2d at 507 (applying Arkansas law); *see also Sanchez*, 551 S.W.2d at 486, fn. 7. Where the defendant cannot prove that he relied on the plaintiff's conduct or that he changed his position to his detriment, estoppel will be ruled inapplicable.

VII. Conclusion

Preferential rights and options have traditionally been found to be desirable, for various reasons, to mineral interest owners contemplating operations under joint operating agreements. The technicalities associated with such rights, however, such as the circumstances that will trigger the right and the duty to comply with notice requirements, have caused problems that have given such rights a poor reputation for reliability. This presentation has attempted to make clear that preferential rights may serve their desired purposes reliably if careful thought is given to their drafting and execution. For this reason, the preferential rights will likely remain a common subject of negotiation in future JOAs.