ASSIGNMENTS AND CONSENT; LET'S BE REASONABLE!

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INTRODUCTION

Contractual provisions requiring a party's written consent before another party to an agreement may assign or sublease its interest to a third party are used in a variety of agreements common to the mining industry. Consent clauses are part of a broader array of restrictions associated with assignments or subleases pursuant to which the parties to an agreement seek to retain a degree of control over their business relationships. Much has been written about other assignment restrictions, including rights of first refusal and preemptive or preferential purchase rights.[1] This paper focuses on the legal issues and practical considerations surrounding the use of assignment or sublease consent clauses.

Two well-recognized forms of agreement currently in use in the mining industry reflect an apparent difference of opinion over the advisability of using assignment consent clauses in the first place. The original drafters of the Rocky Mountain Mineral Law Foundation's Model Form 5 Mining Venture Agreement counsel against the use of a consent clause as the method of discouraging fractionalization of interests and protecting the tax status of the venture participants.[2] Meanwhile, the Foundation's Mining Lease Handbook includes suggested language requiring written consent to assignments, and providing that the consent "shall not unreasonably be withheld."[3]

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[1]E.g., Cooney and Ausherman, "Preferential Purchase Rights in Mineral Agreements," 37 Rocky Mountain Mineral Law Institute 9-1 (1991).

[2]Model Form 5 Commentary at 39. The latest redraft from the Foundation's Form 5 Revision Committee maintains the preference for a preemptive right and other transfer limitations over the use of a consent clause. The Form 5 Revision Committee is due to present its new and improved Model Form 5 at the Foundation's upcoming Annual Program in Sun Valley this July.

[3]G. Reeves, MINING LEASE HANDBOOK at 129 (RMMLF 1992).

The goal of this paper is to assist the practitioner in understanding how common forms of consent clauses are likely to be treated under United States law[4] so that the decision whether and in what form to use such clauses will not be made blindly. In the process, general observations and conclusions are drawn from existing case law--most of it outside the mining context-concerning whether and under what circumstances the decision to withhold consent might be considered reasonable in the mining context, as well as what the potential consequences are of withholding consent unreasonably.

I. COMMON TYPES OF CONSENT CLAUSES AND ISSUES ARISING THEREUNDER

Research discloses that there are four basic types of consent clauses commonly in use. First, some clauses are drafted aggressively to provide that consent may be withheld arbitrarily for any reason. Second, often provisions relating to assignments provide for written consent, but are silent as to whether consent may be withheld arbitrarily or unreasonably. Third, as in the example from the Mining Lease Handbook, the requirement of written consent frequently is accompanied by language providing that consent may not unreasonably be withheld. Finally, some parties have spelled out in considerable detail under precisely what circumstances consent may be withheld. Several legal and practical considerations need to be kept in mind when choosing to employ one of these four types of clauses, as described more fully below.

[4]The focus of this paper is on agreements to which the law in the United States would apply, and the reader is advised to consult the state law applicable to instruments used for a particular project. No effort is made here to analyze agreements to which the law of foreign jurisdictions might apply.

A. Clauses Allowing Consent To Be Withheld Arbitrarily.

Before choosing this type of provision for a mining agreement, the parties would be well-advised to assess whether the agreement creates or concerns real property interests under the law of the applicable jurisdiction. If it does, the widely-recognized common law rule prohibiting unreasonable restraints against alienation likely stands as a significant impediment to the enforceability of such a clause.[5] Since many agreements such as mining leases, farmout arrangements (similar to the kind of deal contemplated by Model Form 5), and exploration or option agreements may be interpreted to create or concern property rights, drafters generally should be reluctant to use this kind of provisions.[6]

The general American principle that parties are free to contract in any manner they see fit is only a general rule which must be tempered by the notion underlying our common law property jurisprudence that real property should remain unfettered by any restraints on assignability that are unreasonable. Ignoring the predominance of this ancient property law concept over contract principles in drafting the assignment consent clause could mean your clause will be left on the courtroom floor after it is cut out of the agreement as unenforceable.

With that counsel, it should be recognized that not all agreements commonly used in the mining industry create or involve real property interests. Thus, for example, contracts for the performance of dirt-moving, drilling, or other such services likely will not give rise to real property

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[5] *E.g.*, *Shields v. Moffitt*, 683 P.2d 530 (Okla. 1984) (restriction on assignment of oil and gas lease).

[6] There is some authority for the proposition that the prohibition on unreasonable restraints against alienation should only be implicated when freehold, as opposed to leasehold, interests are involved. *E.g.*, *Stanolind Oil Gas Co. v. Guertzgen*, 100 F.2d 299 (9th Cir. 1938). A more modern trend, however, suggests the doctrine is not so limited.

interests, although it is not clear under those circumstances how important it would be to retain control over the assignment of contract rights.

There also may be limited ability to negotiate an absolute right to withhold consent in certain jurisdictions. The American Law Institute Is highly-regarded RESTATEMENT (SECOND) OF THE LAW OF PROPERTY contains the following statement among its principles relating to landlords and tenants:

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

RESTATEMENT (SECOND) OF PROPERTY § 15.2(2) (1977) (emphasis added). Although the RESTATEMENT does not itself have the force of law in any jurisdiction, research in the jurisdiction whose law will apply to your agreement may well disclose a judicial acceptance of the quoted formulation.[7] Even then, careful drafting should make it abundantly clear that the right to withhold consent is absolute and that consent may be withheld arbitrarily for any reason. Unfortunately, even such express statements are not the end of the inquiry. According to the RESTATEMENT, an absolute right to withhold consent "is not freely negotiated where the party which must submit to the withholding of consent has no significant bargaining power in relation to the terms of the lease." *Id.*, comment i.

B. Clauses Silent On Whether Consent May Be Withhold Unreasonably

The operation of two legal principles recognized to varying degrees in many jurisdictions need to be understood in connection with clauses that require consent, but that are silent about whether consent may be withheld unreasonably. First, as a matter of commercial contract law, a

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[7] *E.g.*, *Vista Village Mobile Home Park v. Basnett*, 731 P.2d 700 (Colo. 1987) (discussing but not deciding on adoption of § 15.2).

growing number of jurisdictions will imply a covenant of good faith and reasonableness into the clause of the contract.[8] Second, even if reasonableness is not implied as a matter of contract law, courts may rescue the consent provision from the prohibition against unreasonable restraints on alienation by construing the clause to require reasonableness as a matter of public policy.[9]

The tug of the law to require reasonableness even in consent clauses which are silent raises a related point. Because restraints on the alienation of property interests-in particular, unreasonable restraints--are frowned upon under the law, courts tend to strictly construe consent clauses to avoid application of the restraint where possible. Thus, for example, where the consent clause refers only to assignments, subleases may not trigger the consent requirements.[10] Similarly, unless expressly provided for, transfers by operation of law through such events as mergers, stock sales, foreclosures and bankruptcy proceedings will not trigger the consent requirement.[11] The lesson to be learned is that consent clauses, if included at all, need to be drafted deliberately and not included as boilerplate language using general terms. The parties need to consider whether the consent requirement should be made applicable to transfers by operation of law, transfers to related entities, and transfers for security purposes. Express treatment of these matters will avoid later surprises when a court strictly construes a clause as not applying to such transfers.

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[8] *See,. e.g.*, *Campbell v. Westdahl*, 715 P.2d 288, 292 (Ariz. App. 1985) (approving "modern trend" of implying reasonableness requirement into consent provision unless expressly negated).

[9] *See, e.g.*, *Funk v. Funk*, 633 P.2d 586 (Idaho 1981).

[10] *See, e.g.*, *DeBaca v. Fidel*, 297 P.2d 322 (N.M. 1956) (provision prohibiting assignment is not violated by a sublease); *Burns v. Dufresne*, 121 P. 46 (Wash. 1912) (same).

[11] *See, e.g.*, *Francis v. Ferguson*, 159 N.E. 416 (N.Y. 1927) ("very special" language must be used to restrict transfers by operation of law); *Branmar Theatre Co. v. Branmar, Inc.*, 264 A.2d 526 (Del. 1970) (stock transfers do not violate a restraint unless the clause expressly so requires).

C. Clauses Expressly Providing That Consent Kay Not Unreasonably Be Withhold

As described above, the law of many jurisdictions will imply a reasonableness requirement into consent clauses.[12] When the law tends to imply obligations, it does not take long for lawyers to prefer that the obligations be made express. Thus, as in the Mining Lease Handbook, it is common to include language that consents to assignments or subleases may not unreasonably be withheld. The drafter needs to be aware, however, that making the reasonableness requirement an express covenant can lead to adverse consequences under the law.

For example, the case law generally holds that the inclusion of an express reasonableness requirement constitutes a covenant the breach of which gives rise to an action for damages.[13] Where the reasonableness requirement is implied, by contrast, courts tend to conceive of the requirement as nothing more than a limitation on the requirement to seek consent whereby the party withholding consent can be forced to live with the assignment or sublease, but damages generally would not be recoverable.

Given the potential differences in remedies available, some lessors, for example, may be better served to leave the consent clause silent to avoid the significant risk of a damages claim when consent is withheld. The risk of such an approach, of course,, is that the clause might be deemed a prohibited restraint depending upon the nature of the agreement and the jurisdiction.

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[12]When the RESTATEMENT (SECOND) OF PROPERTY adopted this approach in § 15.2, it acknowledged that at the time only a minority of jurisdictions required a party to be reasonable in withholding consent where reasonableness was not a term of the contract. It now appears that a majority of jurisdictions have adopted such an approach.

[13]*E.g.*, *Fahrenwald v. La Bonte*, 653 P.2d 806 (Idaho App. 1982).

D. Clauses Enumerating Under What Circumstances Consent May Be Withhold

There are examples of cases where consent clauses have enumerated acceptable reasons for withholding consent, and at least one article has recommended this approach.[14] This approach in most cases should succeed in eliminating the uncertainty of an implied reasonableness standard or an avoidance of the clause as an unreasonable restraint against alienation. It may not be the best approach in all cases, however.

In at least one case where the parties specified reasons f or which consent could be withheld, a court has held that the specification of reasons was an affirmative covenant not to withhold consent for other reasons such that an action for damages from a breach of the covenant would be recognized.[15] Thus, the same consideration involved in the decision whether to expressly provide that consent shall not unreasonably be withheld applies to this kind of clause. That is, parties who expect to be put in the position of deciding whether to withhold consent may not find this approach attractive.

A further potential difficulty with enumerating reasons for withholding consent is that in many instances it may be difficult to predict during negotiations why a party might reasonably want to withhold consent. Negotiations often are conducted in a vacuum, and clearly the party who might later be asked to consent cannot usually predict future assignees or sublessees or the mix of reasons why entering into a mining relationship with those parties might be undesirable. For all its faults in terms of predictability of outcome, the reasonableness approach can be attractive for its flexibility.

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[14]Sager & Henderson, "Assignment Provisions in Mining Agreements," 27 Rocky Mountain Mineral Law Institute 887 (1982).

[15]*See*, *Hedgecock v. Mendel*, 263 P. 593 (Wash. 1928).

II. THE APPLICATION OF THE REASONABLENESS STANDARD

Reasonableness, of course, is in the eye of the beholder. Notwithstanding, where the term is employed in the law the standard against which it is measured is that of a so-called "prudent man" under like circumstances. Thus, the law seeks to evaluate reasonableness objectively, with the significant caveat that the circumstances in which the issue arises are relevant to the determination.

By far the largest body of cases considering the reasonableness of withholding consent arises from the context of landlords withholding consent to assignments or subleases attempted by their tenants.[16] Many of these cases define reasonableness in terms of platitudes such as whether decisions are based on "objective, sensible factors of a substantial nature." The factual profile emerging from the cases is telling, however. Withholding consent frequently is upheld where there is some indication that the tenant lacks the financial stability or creditworthiness to perform and pay the rent under the lease, where the proposed assignee or sublessee is of a disreputable or unreliable character, or where the proposed use of the premisees differs radically from the prior tenant or would be financially detrimental to the landlord's commercial interest.[17]

The concerns identified as reasonable in the commercial leasing context arguably are intensified in the mining agreement context. First, the relationships embodied in mining arrangements frequently go well beyond the landlord/tenant relationship, such as where mining

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[16]*See*, Annotation, "Construction and Effect of Provision in Lease that Consent to Subletting or Assignment Will Not be Arbitrarily or Unreasonably Withheld," 54 A. L. R. 3d 679; Annotation, "When Lessor May Withhold Consent Under Unqualified Provision in Lease Prohibiting Assignment or Subletting of Lease to Premises Without Lessor's Consent," 21 A.L.R.4th 188 (1983); Annotation, "Right of Lessor Arbitrarily to Refuse or Withhold Consent to Subletting or Assignment Which is Barred Without Such Consent," 31 A.L.R.2d 831 (1953).

[17]*See, e.g.*, *Riggs v. Murdock*, 458 P.2d 115 (Ariz. App. 1969) (financial stability is a reasonable criterion); *In re Van Ness Auto Plaza, Inc.*, 120 B.R. 545 (N.D. Cal. Bkrtcy Ct. 1990) (factors closely related to likelihood that proposed assignee will successfully perform are reasonable).

companies are joint venturers, mining partners or other forms of business associations.[18] Under these circumstances, expectations of reliability, creditworthiness, and stability are intensified. Factors such as the ability to secure loans, to obtain bonding or insurance, to avoid intensified public scrutiny from a company's past environmental record and to get along compatibly with management of the new business relation, among many others, represent fertile grounds for a finding that it would be reasonable not to consent to the new business relationship.

Even in the mining lease context, which is analogous to the commercial landlord and tenant scenario,[19] the lessor's economic interests go well beyond the interests of a commercial lessor. In an article addressing the oil and gas lease context, one commentator has identified these economic interests as falling into five categories:

> (1) the lessor's reliance on the reputation, skill, and financial position of the original lessee;
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> (2) the lessor's desire to share in any increased value of the leasehold;
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> (3) the lessor's desire to prevent the creation of excessive noncost-bearing interests which may discourage development;
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> (4) the lessor's desire to know the current owners of the leasehold; and
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> (5) the lessor's desire to avoid a large number of recorded transactions which will increase abstracting fees for routine transactions such as secured loans.[20]

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[18]If the agreement involved creates a special relationship such as a general partnership, mining partnership or cotenancy, consult the jurisdiction's statutory rules governing assignments of these interests.

[19]*See D.A.C. Uranium Co. v. Benton*, 149 F. Supp. 667 (D. Colo. 1956), (lease of mining claims analyzed under landlord-tenant law); *Couch v. Welsh*, 66 P. 600 (Utah 1901) (same).

[20]Pierce, "An Analytical Approach To Drafting Assignments," 44 S.W. Law Journ. 93, 950 (Fall 1990).

This list suggests numerous reasonable bases that might be argued by a mining lessor desiring to withhold consent to a replacement mining company entering upon the land for lease exploration, development or mining purposes.[21]

Just as general patterns can be gleaned from cases finding that consent was reasonably withheld, so too a pattern arises from cases where the refusal to provide consent was held to be unreasonable. Thus, for example, where the party refusing to give consent was provided with reasonable assurances as to performance of the agreement, such as through a guarantee of performance by the original party to the agreement, refusal to consent often is held to be unreasonable. Several other cases stand for the proposition that withholding of consent is unreasonable when based on personal tastes or preferences unrelated to the ability to perform under the agreement.[22] A third line of cases suggests a party is unreasonable if consent is withheld after being made conditional on some additional concession or financial benefit that would leave the party from whom consent is sought better off than under the original terms of its agreement.[23] A fourth line of cases recognizes unreasonableness where the party provides no reason for withholding consent when consent is requested.

III. PRACTICAL CONSIDERATIONS IN CONSENT NEGOTIATIONS

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[21]A small minority of jurisdictions appears to hold that a mining lease is not assignable by the lessee since it was the lessee's personal skill and mining experience for which the lessor contracted. *E.g.*, *Hodgson v. Perkins*, 5 S.E. 710 (Va. 1888) (gold mining lease).

[22]*E.g.*, *Kendall v. Ernest Pestana, Inc.*, 709 P.2d 837 (Cal. 1985) (withholding consent on the basis of personal taste, convenience or sensibility was not commercially reasonable).

[23]*E.g.*, *Economy Rentals, Inc. v. García*, 819 P.2d 1306 (N.M. 1991). *Chanslor-Western Oil & Dev. Co. v. Metropolitan Sanitary Dist.*, 266 N.E.2d 405 (Ill. 1970) (withholding consent unreasonable where made conditional upon altering lease terms); *Bedford Inv. Co. v. Folb*, 180 P.2d 361 (1947) (unreasonable where conditioned upon sharing profits from the assignment).

Parties on both sides of consent negotiations should recognize that their actions can influence a court's decision whether the withholding of consent was reasonable under the circumstances. Obviously the party seeking consent needs to timely request consent. Once consent is requested, a reluctant party may want to develop a list of relevant information to request from the party seeking consent and from the proposed assignee. If the requested information was reasonable but the party seeking consent was not forthcoming, cases reveal that the likelihood withheld consent will be held reasonable is increased.[24] By the same token, if requested information is provided and consent ultimately denied, the party wishing to assign should inquire into the reasons for denial. Courts have held that a nonconsenting party is unreasonable if it provides no reasons for the refusal after the reasons are requested.

Thus, whereas the ultimate standard of reasonableness is the objective prudent man test, clearly a party can influence the application of that standard by conducting itself reasonably during the negotiations leading to a party's refusal to consent. Conduct particularly damaging to a party withholding consent includes the party's attempt to extract a pound of flesh from the party seeking consent. An interesting question beyond the scope of this presentation is whether a party succumbing to such a demand in order to avoid ruining a pending valuable transaction might later be able to avoid the concession on the basis of legal theories such as failure of consideration, duress or coercion.

IV. ADDITIONAL CONSIDERATIONS

Although this paper focuses by design on consent clauses, recognize that other drafting devices may serve the same general goals that underlie the use of consent clauses. In addition to

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[24] *E.g.*, *D'Oca v. Delfakis*, 636 P.2d 1252 (Ariz. App. 1981) (reasonable to withhold consent if inadequate information provided).

rights of first refusal and preemptive or preferential purchase rights, a variety of clauses might be employed to accomplish the same or similar goals. For example, the agreement can include a requirement that original parties remain liable for performance of the agreement, or that original parties and subsequent assignees or sublessees will be jointly and severally liable for performance. Another approach might be to provide forfeiture or termination of the agreement upon any attempt to assign. As has been observed, the form a mining agreement takes is limited only by the imaginations of the parties.[25]

If a consent clause is chosen, the drafter should be aware of the possible application of the English common law rule in *Dumpor's Case*, 4 Coke 1196 (1578), in a given jurisdiction. Although the rule may be altered by agreement of the parties, it would hold that a lessor's consent to one assignment will obviate the need for the lessor's consent to subsequent assignments.

CONCLUSION

Assignment consent clauses in mining agreements frequently can lead to unintended consequences. Due to the fact-intensive nature of the reasonableness inquiry applicable where reasonableness is an express or implied requirement of the consent clause, results of disputes over consent cannot be predicted with certainty. Moreover, principles of strict construction and even the harsh consequences of the prohibition on unreasonable restraints against alienation can frustrate a party's reasons for selecting the clause. As a result, some commentators have counseled against the use of consent clauses in favor of other drafting devices designed to achieve the same or similar results.

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[25]Sager & Henderson, "Assignment Provisions in mining Agreements," 27 Rocky Mountain Mineral Law Institute 887, 888 (1982).

Notwithstanding, assignment consent clauses remain a fact of life as part of existing agreements and, no doubt, as part of future negotiations in the mining industry. As a result, negotiators and drafters would do well to study the mix of contract and property principles implicated by the use of consent clauses in order to better inform their drafting decisions and avoid unnecessary surprises. Above all, once consent clauses are implicated by a party's desire to assign or sublease, the parties, by conducting themselves reasonably in consent negotiations, can avoid the increasingly unreasonable expense of litigation.

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