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COMMERCIAL OPTIONS: NOW SUBJECT TO REVISION BY THE COURTS?

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In a recent decision[1] involving a $21 million dispute over an option for mineral rights, the Colorado Supreme Court, in extensive dicta, seemed to signal a major shift in the law that will apply to commercial options. The shift appears to be toward a "flexible" approach in which the court, not the parties or the law existing at the time of the option, will determine how long any commercial option involving land or minerals will be allowed to continue.

A description of the case, the difficulties that might be expected from the new approach, and a suggestion for a more workable solution follow.

I. SUMMARY OF THE CASE

In 1983 Atlantic Richfield (ARCO) granted Equity Oil (Equity) an option to buy back certain mineral rights.[2] Equity attempted to exercise the option in 2006 and ARCO refused to comply with the option—claiming that the option violated the common law rule against perpetuities, as the rule existed when ARCO granted the option to Equity.[3] The trial court agreed that the option violated the rule against perpetuities.[4] It then reformed the option, under the provisions of C.R.S. 15-11-1106(2), and granted specific performance of the reformed option.[5] The court of appeals affirmed.[6] The Colorado Supreme Court granted certiorari on August 1, 2011 on the issue of whether or not the trial court should have applied statutory reformation to the option.[7]

Then on March 3, 2014, the Colorado Supreme Court skillfully dodged the issue by holding, correctly, that the 1983 option was not sub-

1. *Atl. Richfield Co. v. Whiting Oil & Gas Corp.*, 320 P.3d 1179 (Colo. 2014).
2. *Id.* at 1182.
3. *Id.*
4. *Id.*
5. *Id.*
6. *Whiting Oil & Gas Corp. v. Atl. Richfield Co.*, 321 P.3d 500 (Colo. App. 2010), *aff'd on other grounds*, 320 P.3d 1179 (Colo. 2014).
7. *Atl. Richfield Co. v. Whiting Oil & Gas Corp.*, No. 10SC688, 2011 WL 3276261 (Colo. Aug. 1, 2011). The issues stated were: "[w]hether the Statutory Rule against Perpetuities Act's reformation provision, section 15-11-1106(2), C.R.S. (2009), authorizes a court to reform a non-donative, commercial option created prior to the effective date of the Act in order to bring it into compliance with the common law rule against perpetuities[,]" and "[w]hether the reformation provision is unconstitutionally retrospective, where such reformation deprives a party of its vested interest in real property."

ject to the rule against perpetuities anyway since it was unilaterally revocable by ARCO at any time.[8]

That makes the remainder of the opinion dicta, but important dicta, as a signal to the route the court intends to follow in determining the validity of commercial options in the future.

Surprisingly, in its opinion in *Atlantic Richfield v. Whiting Oil*, the Colorado Supreme Court discussed the 1969 version of *Atchison v. City of Englewood* (hereinafter *Atchison II*)[9] extensively but failed to make any mention of the later version of the same case, *Atchison v. City of Englewood* (hereinafter *Atchison III*),[10] which was directly relevant to the issue at hand.

In *Atchison III*, the Colorado Supreme Court, *without any statutory authority*, had simply reformed a commercial option that it found to violate the rule against perpetuities and then enforced the option.[11] Since reformation of a commercial option was the announced issue in *Atlantic Richfield v. Whiting Oil*,[12] it is somewhat difficult to understand why the court did not discuss the one case directly on point.

Instead, having decided that the ARCO option at issue simply was not subject to the rule against perpetuities, the court went on to state a "flexible" new analysis that it stated would be "equally applicable to *both* commercial transactions in property as well as to donative transfers."[13]

II. THE NEW ANALYSIS

According to the extensive dicta in the ARCO case,[14] the new standard for determining the validity of commercial options[15] will be the

8. *Atl. Richfield v. Whiting Oil*, 320 P.3d at 1190 (quoting JOHN CHIPMAN GRAY, The Rule Against Perpetuities 191 (Roland Gray ed., 4th ed. 1942)) ("Professor Gray, who articulated the classic formulation of the common law rule against perpetuities, long ago acknowledged that '[i]f the owner of the present interest in property is at liberty to destroy a future interest, that interest is not within the scope of the Rule [a]gainst Perpetuities.'").

9. *Atchison v. City of Englewood*, 463 P.2d 297 (Colo. 1969) [hereinafter *Atchison II*].

10. *Atchison v. City of Englewood*, 568 P.2d 13, 16-17 (Colo. 1977), *superseded by statute*, C.R.S. § 38-30-167 (2001), *as recognized in* Brush Grocery Kart, Inc. v. Sure Fine Mkt., Inc., 47 P.3d 680, 682-83 (Colo. 2002).

11. *Id.*

12. *Atl. Richfield v. Whiting Oil*, 320 P.3d at 11980.

13. *Id.* at 1185 (emphasis added).

14. *Id.*

15. Note that the Colorado Supreme Court also seems to intend to apply the flexible, uncertain rule of "unreasonable restraint on alienation" to donative transfers, as well! *Id.* Will this turn out to be the way the courts will limit the very questionable use of "Dynasty Trusts" specifically authorized by C.R.S. § 15-11-1102.5(1)(b)(I), permitting private trusts to continue for up to 1,000 years? Allowing a private trust to continue for as long into the future as the year 1015 is in the past certainly seems unreasonable! Yet such trusts are clearly authorized by C.R.S. § 15-11-1102.5(1)(b)(I). So will the courts, in the future, simply use "unreasonable restraint on alienation" to override the specific words of the statute? *See* Lucy A. Marsh, *The Demise of Dynasty Trusts: Returning the Wealth to the Family,* 5 EST. PLAN. & COMMUNITY PROP. L.J. 23, 40–46 (2012) for arguments against Dynasty Trusts.

seldom-used rule against "unreasonable restraints on alienation."[16] As explained by the court:

> The rules against unreasonable restraints on alienation generally aim to keep assets available for commerce by applying different types of limits depending on the *nature* of the property, the *purpose* of the restraint, and its *potential for harm*. The rule against unreasonable restraints "is applied by considering the reasonableness of the restraint." "Determining reasonableness of a restraint on alienation requires *balancing the utility of the purpose* served by the restraint *against the harm* that is likely to flow from its enforcement." In making such a determination, courts must evaluate the "nature, extent, and durations of the restraint," as well as the "*nature of the property interest and the type of land* or development involved." This flexible analysis is *equally applicable to both commercial transactions* in property as well as to *donative* transfers.[17]

So from now on, Colorado courts will be asked to balance "the utility of the purpose . . . against the harm that is likely to flow" and "the nature of the property . . . involved" every time there is a dispute as to the enforceability of a commercial option. What a wonderful "full employment bill" for lawyers, and what an unfortunate new burden for the courts.

In the ARCO case, just how might one impartially calculate the "utility of the purpose . . . against the harm likely to flow"[18] from an option freely entered into by two large oil companies roughly twenty-three years before the litigation arose?

It may be that members of the Colorado Supreme Court, like nearly all lawyers in Colorado, do not want to have to deal with the remarkably convoluted provisions of the relatively new Statutory Rule Against Perpetuities.[19] Who could blame them? However, case by case litigation

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16. *Atl. Richfield v. Whiting Oil,* 320 P.3d at 1185. Although the rule against restraints on alienation is not a new rule it has generally not been used as an independent method of limiting the *duration* of a land use restriction, since that function has been adequately performed by the rule against perpetuities. Instead, the rule against restraints on alienation has more often been used to prohibit partial restraints on sale, such as prohibiting sale to specific persons, or for striking down various land use restrictions. *See* WILLIAM M., MCGOVERN, JR., && SHELDON F. KURTZ, WILLS, TRUSTS AND ESTATES §§11.8 (2d ed. 2001).

17. *Atl. Richfield Co.*, 320 P.3d 320 P.3d at 1185 (emphasis added) (internal citations omitted).

18. *Id.*

19. *See e.g.*, C.R.S. § 15-11-1102.5(1) (2015); C.R.S. § 15-11-1102.5(2) (2015); C.R.S. § 15-11-1102.5(2)(b)(V) (2015) (stating, as perhaps the most convoluted clause of all time,1991), "[i]f in measuring a period from the creation of a trust or other property arrangement for purposes of interests, powers, and trusts subject to this paragraph (b), language in a governing instrument seeks to disallow the vesting or termination of any interest or trust beyond, seeks to postpone the vesting or termination of any interest or trust until, or seeks to operate in effect in any similar fashion upon the later of the expiration of a period of time not exceeding twenty-one years after the death of the survivor of specified lives in being at the creation of the trust or other property arrangement or the expiration of a period of time that exceeds or might exceed twenty-one years after the death of the survivor or [sic] lives in being at the creation of the trust or other property arrangement, that lan-

over the validity of commercial options each time one party to the option claims that the option has turned out to be "unreasonable," does not seem to be a wise solution.

III. A PROPOSED SOLUTION

Having spent more than forty years attempting to teach students to understand the basics of the rule against perpetuities, I am well aware that most lawyers do not even want to think about it. Yet almost everyone agrees that there should be some limit on dead-hand control, so that old restrictions do not so entangle land so much that it cannot be put to productive use.[20]

When promulgating the Uniform Statutory Rule against Perpetuities the Uniform Law Commissioners, under the influence of Prof. Waggoner, stated that restrictions should be limited to a period of ninety years.[21] When asked why ninety years was selected, Prof. Waggoner confidently replied, "Ninety years is the average life expectancy of a six year old."[22] Really? And why should a six year old have any particular significance in determining the duration of a land use restriction or a commercial option?

Instead, why not adopt legislation that simply, clearly, abolishes the common law rule against perpetuities to the resounding cheers of law students and lawyers alike?[23]

Then, in order to prevent commercial and private[24] land use restrictions from enduring for an unreasonable period of time, we could simply provide that no restriction or option is enforceable for more than

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guage is inoperative to the extent it produces a period of time that exceeds twenty-one years after the death of the survivor of the specified lives").

This lovely provision was added to the Uniform Act when the illustrious drafters of the Uniform Act belatedly realized that they had failed to take into consideration the effect of the "Delaware Tax Trap." Hopefully, a careful look at the Uniform Statutory Rule Against Perpetuities, from which the Colorado Act was derived, will illustrate that even the illustrious Uniform Commissioners may lose track of common sense when faced with an issue involving the common law Rule Against Perpetuities. We should be able to do better than to follow along the convoluted statutory path, which is currently the statutory law in Colorado.

20. *See e.g.*, Ind. Code § 32-17-10-2 (20153), ("A possibility of reverter or right of entry for breach of a condition subsequent concerning real property is invalid after thirty (30) years from the date the possibility of reverter or right of entry is created, notwithstanding a period of creation longer than thirty (30) years . . . .").

21. Unif. Statutory Rule Against Perpetuities§§ 1(a)(2) (NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 1990).), 8A U.L.A. 80 (1987).

22. Jesse Dukeminier, *The Uniform Statutory Rule Against Perpetuities: Ninety Years in Limbo,* 34 UCLA L. Rev. 1023, 1034 (1987)3, ("[T]he Act takes a six-year-old's life expectancy and adds 21 years to it. Not a scrap of hard data—-not a single bit of empirical information about the actual ages of the parties in Rule-violating trusts—-is offered for this inherently implausible assumption."); *Id.* at 1033.

23. *See* LUCY A. MARSH, WHAT IF WE SIMPLY ABOLISHED THE RULE AGAINST PERPETUITIES? COLO. TR. (Colorado Trusts & Est. Council Notes July 2000).

24. Conservation easements and the like might be excluded as restrictions imposed by the government, for the benefit of the population as a whole.

100 years after the date on which the document creating the restriction became effective. Thus, someone checking title for mineral interests, or checking to see whether restrictions on land use are still enforceable, could simply disregard any restrictions created in a document that went into effect more than 100 years previously.

The common law rule against perpetuities allowed restrictions that would last for twenty-one years after "some life in being at the creation of the interest," which would be roughly 100 years. Perhaps that is an appropriate length of time. Perhaps it should be shorter.

In any case, under the proposed new rule, commercial entities, as well as individuals, would simply be bound for up to 100 years (but no longer) by the bargains they have entered into even though it turns out that the bargain may have caused a benefit to one side and a loss to the other side. Most well designed options, of course, are drafted to last for a much shorter time. But, at least the proposed new rule would provide a clear, definite, outer limit to the duration of any option.

Certainly that would be more efficient than allowing any disappointed party to a commercial option to litigate (or threaten to litigate with the benefit of hindsight) as to whether or not the option when signed constituted an "unreasonable restraint on alienation."

Balancing the "utility of the purpose" of an option for mineral rights against "the harm that is likely to flow from its enforcement" twenty-three or fifty years after the option went into effect might be a difficult task for any court, and one that need not be undertaken if the law is simply made clear that options cannot continue for more than 100 years, or 50 years, or whatever time period seems appropriate to the legislature.

Parties to an option, of course, would always be free, by written agreement, to re-negotiate the terms of the option. But any option which had not been updated within the preceding 100 years would simply be void.

Before a case reaches the Colorado Supreme Court that *does* require application of the virtually incomprehensible Colorado Statutory Rule Against Perpetuities, we should enact a new rule, clearly defining the duration of permissible restraints on the ownership and use of land and clearly stating that no land use restriction or option involving land is valid for more than 100 years after the date of its creation. One hundred years of dead-hand control should be enough.

Anyone entering into a commercial transaction should not be subjected to the uncertainty of wondering what some court, balancing numerous factors many years later, might determine to have been "unreasonable."

Although the common law rule against perpetuities was perhaps difficult to understand, the rules were certain, and careful lawyers could

easily draft options that did not violate the rule, either by limiting the option to last for no more than 21 years, or by building in a "life in being"[25] so that the option could continue for a life plus twenty-one years.

Now, if the Colorado Supreme Court adopts the dicta of *Atlantic Richfield v. Whiting Oil,* even the most careful lawyer will have no guarantee that a court will not later "balance" the option against various factors and declare it void. Commercial transactions do not need this added uncertainty, and courts do not need the additional, time-consuming litigation—or threats of litigation.

25. See*, e.g.*,, LUCY A. MARSH, PRACTICAL APPLICATIONS OF THE LAW: REAL PROPERTY TRANSACTIONS 355 (Marsh, Little, Brown & Co 1992) (quoting the, § ."). LUCY A. MARSH, 355(("The right of first refusal, as provided herein, shall extend and run for the period of the lives of Brad Wolff, Frank Perkins, and Thomas Grimshaw, the Incorporators of Three Fountains Association, and the survivor of them, plus twenty-one years.") (quoting Condominium Declaration for Three Fountains Filing No. 1, § Sec. 25).