

**TURN AROUND, DON'T DROWN: A NEW
GENERATION OF OIL AND GAS LEASE
“WASHOUTS” IN TEXAS AND HOW TO AVOID
THEM**

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I. INTRODUCTION

Well, now, there is a tiny creature . . . with enormous problems. How he has survived throughout the ages . . . is one of nature’s big mysteries. His life is hazardous. Downright dangerous. Uh, would you like to try it?

Oh, no, I’d better not.¹

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1. THE SWORD IN THE STONE (Walt Disney Productions 1963).

Like the noble squirrel in Disney's classic animated film, the life of a non-operating interest in an oil and gas lease can be fraught with peril. Lacking the clout and control of a lease operator with a majority working interest, overriding royalty owners' complaints about non-payment are often a low priority, and small fractional working interest owners often struggle to obtain payout accountings. But the most dreaded predator of all is the infamous washout.

At the risk of mixing metaphors, a lease washout transaction is a procedure used by lease operators to eliminate non-operating interests, much like a flood washing out a country road. For better or worse, washouts are not a rare occurrence in the oil and gas industry. Although they are most often associated with overriding royalty interests,² washouts can happen to any type of non-operating interest in an oil and gas lease, such as a back-in option,³ net profits interest,⁴ security interest,⁵ or a non-operating working interest.⁶

This Article will review Texas case history on the enforcement of washout transactions and the efficacy of anti-washout clauses, examine three new Texas cases that have expanded our jurisprudence regarding washouts, and explore ways for non-operating interest owners to protect themselves from washouts.

II. LEASE WASHOUTS IN GENERAL

In a broad sense, “[a] washout describes conduct by the lessee designed to extinguish the burden of a nonoperating interest, such as an override, while still effectively preserving the lessee’s interest.”⁷ More specifically, a washout is the “[e]limination of an overriding royalty or other share of the working interest by the surrender of a lease by a sublessee or assignee and subsequent reacquisition of a lease on the same land free of such interest.”⁸

The purpose of a washout transaction is to eliminate revenue burdens on the operating lessee’s working interest or annex competing non-operating working interests.⁹ The operating lessee achieves this by taking advantage of existing contract terms, as opposed to directly acquiring the outstanding

2. See generally 2 ERNEST E. SMITH & JACQUELINE LANG WEAVER, TEXAS LAW OF OIL AND GAS §§ 2.4(B)(3), 16.5(A)(3)(b) (LexisNexis Matthew Bender, 2nd ed. 2021).

3. See TRO-X, L.P. v. Anadarko Petroleum Corp., 548 S.W.3d 458, 548 (Tex. 2018).

4. See Ultra Res., Inc. v. Hartman, 226 P.3d 889, 909 (Wyo. 2010).

5. See Macquarie Bank Ltd. v. Knickel, 723 F. Supp. 2d 1161, 1168–69 (D.N.D. 2010).

6. See Cimarex Energy Co. v. Anadarko Petroleum Corp., 574 S.W.3d 73, 95 (Tex. App.—El Paso 2019, pet. denied).

7. Lawrence P. Terrell, *Overriding Royalties and Like Interests—A Review of Nonoperating Lease Interests*, ROCKY MT. MIN. L. INST. 4–16 n.161 (1993).

8. PATRICK H. MARTIN & BRUCE M. KRAMER, WILLIAMS & MEYERS MANUAL OF OIL AND GAS TERMS 1211 (16th ed. 2015).

9. Terrell, *supra* note 7, at n.162 (“The lessee obviously has an economic incentive to eliminate such burdens, since they diminish his net share of production and profit.”).

interest. Although washouts have historically referred to the intentional elimination of lease burdens in bad faith as evidenced by the operating lessee acquiring a new lease before termination of the original lease,¹⁰ Texas case law has consistently treated the operating lessee's intent as immaterial.¹¹ Note that the term "non-operating interest" is used herein to simply describe an interest in an oil and gas lease that cannot or does not drill and operate oil and gas wells.¹²

Broken down into its component parts, a washout transaction occurs when: (1) the operating lessee of an oil and gas lease releases its interest in the lease or allows it to terminate under its terms; (2) the release or termination causes another party's non-operating interest to likewise terminate; and (3) the operating lessee acquires a new lease covering the mineral interest formerly covered or burdened by the now-terminated non-operating interest, free and clear of such interest.¹³ However, these elements are not absolute requirements; washouts come in a variety of flavors. In some cases, the operating lessee acquired the underlying fee mineral interest, eliminating the need for a new lease.¹⁴ The operating lessee in one recent case, discussed below, achieved a washout of a working interest cotenant under a separate lease without surrendering its own lease.¹⁵

The extension-or-renewal clause, or "anti-washout" clause, is a common feature in cases challenging washout transactions.¹⁶ They are intended to prevent washouts by "entitling the owner of such interest to share in any extension or renewal of the lease or other interest out of which the nonoperating interest has been carved or reserved."¹⁷ They also commonly cover new leases or top leases taken by the same lessee on the same mineral

10. See *Sunac Petroleum Corp. v. Parkes*, 416 S.W.2d 798, 804 (Tex. 1967) ("Another situation in which some courts have protected the holder of the overriding royalty is called a 'washout' transaction, generally involving some bad faith on the part of the lessee. In this type of situation, the operator takes a new lease before the expiration of the old lease and then simply permits the old lease to expire.").

11. See *Ridge Oil Co. v. Guinn Invs., Inc.*, 148 S.W.3d 143, 154 (Tex. 2004); *Stroud Prod., L.L.C. v. Hosford*, 405 S.W.3d 794, 803–04 (Tex. App.—Houston [1st Dist.] 2013, pet. denied).

12. More specifically, it is used to describe an interest in an oil and gas lease that either: (1) by its nature, lacks the legal authority to operate, such as an overriding royalty, production payment, or security interest; or (2) bears the legal authority to operate, but cannot economically do so or otherwise elects not to do so for practical reasons. Cf. *MARTIN & KRAMER*, *supra* note 8 (defining the term "nonoperating interest").

13. See 2 *PATRICK H. MARTIN & BRUCE M. KRAMER, WILLIAMS & MEYERS OIL AND GAS LAW* § 420.2 (LexisNexis Matthew Bender 2021); M. C. Cottingham Miles & Paul J. Benavides, *Contracting for Clarity: Practical Solutions for Drafting Around the Current State of the Law Affecting Overriding Royalty Interests*, 46 TEX. TECH L. REV. 1043, 1045–50 (2014).

14. See *In re GHR Energy Corp.*, 972 F.2d 96, 100 (5th Cir. 1992) (holding that extension-and-renewal clause was not enforceable as to unleased fee mineral interest acquired by former lessee); see also *Lonabaugh v. Midwest Refin. Co.*, 285 F. 63, 67 (D. Wyo. 1922).

15. See *Cimarex Energy Co. v. Anadarko Petroleum Corp.*, 574 S.W.3d 73, 76 (Tex. App.—El Paso 2019, pet. denied) (discussed *infra* note 158).

16. See *Terrell*, *supra* note 7, at n.182; *WILLIAMS & MEYERS*, *supra* note 13, at § 428.1.

17. *WILLIAMS & MEYERS*, *supra* note 13, at § 428.1. This treatise section also contains several examples of common and uncommon anti-washout clauses. *Id.*

interest.¹⁸ Extension-or-renewal clauses are generally enforceable when the facts fit squarely within the terms of the clause.¹⁹

Privity is a defining feature of a washout transaction. The lessee under the new lease generally will not be bound by an anti-washout clause burdening the original lease unless that lessee, or possibly an affiliate,²⁰ owned an interest in the original lease. For example, in *McCormick v. Krueger*, a lease terminated for lack of production, and a third party bought the surface equipment and well casing from the lessee pursuant to a customary salvage clause in the original lease.²¹ An overriding royalty owner in the original lease claimed that its override burdened the new lease under the extension-or-renewal clause in its assignment.²² The court disagreed, holding that the third party's new lease was not subject to the extension-or-renewal clause because the third party never owned an interest in the original lease and purchase of salvage property was not enough to create privity of contract with the prior lessee.²³

III. CASE HISTORY OF LEASE WASHOUTS

This Section will review Texas case history on the enforcement of washout transactions and the efficacy of anti-washout clauses. These cases are grouped into two categories: overriding royalty washouts and working interest washouts.

A. Overriding Royalty Washouts

In Texas, “[a]n overriding interest created by assignment does not survive the termination of the assigned lease unless the instrument creating the overriding interest provides an express provision to the contrary.”²⁴ This principle, while perfectly sound as a matter of contract, is what allows for the washout of overriding royalties. Texas courts have imposed a fiduciary-like

18. *Id.*; see *Yowell v. Granite Operating Co.*, No. 18-0841, 2020 WL 2502141, at *4 (Tex. May 15, 2020); *TRO-X, L.P. v. Anadarko Petroleum Corp.*, 548 S.W.3d 458, 464 (Tex. 2018).

19. See *Crimson Expl., Inc. v. Magnum Producing L.P.*, No. 13-15-00013-CV, 2017 WL 6616740, at *7 (Tex. App.—Edinburg Dec. 28, 2017, pet. filed); *EOG Res., Inc. v. Hanson Prod. Co.*, 94 S.W.3d 697, 700 (Tex. App.—San Antonio 2002, no pet.); *Otter Oil Co. v. Exxon Co., U.S.A.*, 834 F.2d 531, 535 (5th Cir. 1987); *Ultra Res., Inc. v. Hartman*, 226 P.3d 889, 926 (Wyo. 2010).

20. See *Macquarie Bank Ltd. v. Knickel*, 723 F. Supp. 2d 1161 (D.N.D. 2010) (involving affiliate of operator who took new leases and was subject to anti-washout clause).

21. *McCormick v. Krueger*, 593 S.W.2d 729 (Tex. Civ. App.—Houston [1st Dist.] 1979, writ ref'd n.r.e.).

22. *Id.*

23. *Id.* at 730–31; see also *Fain & McGaha v. Biesel*, 331 S.W.2d 346, 348 (Tex. App.—Fort Worth 1960, writ ref'd n.r.e.) (rejecting argument that “any new leaseholder receiving an oil and gas lease from the mineral fee owners would take such lease burdened by the same obligation”).

24. *SM Energy Co. v. Sutton*, 376 S.W.3d 787, 790 (Tex. App.—San Antonio 2012) (quoting *EOG Res., Inc.*, 94 S.W.3d at 703).

duty on executive rights holders to protect non-participating royalty interests, but overriding royalty owners have no such judicial protection.²⁵ As demonstrated by the following cases, “[c]urrent case law leaves the [override] owner particularly vulnerable to washouts absent contrary language in the [override]-creating instrument.”²⁶

I. Sunac Petroleum v. Parkes

Although earlier Texas cases have addressed the topic,²⁷ the seminal case on washout transactions in Texas is *Sunac Petroleum Corp. v. Parkes*.²⁸ In *Sunac*, an oil and gas company owned an oil and gas lease that was subject to a previously reserved overriding royalty. The lease assignment that reserved the override contained an anti-washout clause providing that it would apply to any “extensions or renewals” of the lease but did not specify that it would apply to new leases taken by the lessee on the same mineral interest.²⁹

Three days prior to the expiration of the lease’s primary term, the lessee pooled the lease with adjacent acreage to form a 640-acre unit for production of gas only.³⁰ When the primary term ended, there was no production or operations on the lease itself, but a well was being drilled on adjacent acreage within the gas unit.³¹ The well was soon completed as an oil well rather than a gas well.³² Shortly after the end of the primary term, the lessee began drilling a second well on the lease itself, which was also completed as an oil well.³³ The successors-in-interest to the lessor asserted that the lease had

25. See generally SMITH & WEAVER, *supra* note 2, at §§ 2.6(C), 2.4(B)(3).

26. Miles & Benavides, *supra* note 13, at 1045.

27. See MacDonald v. Follett, 142 Tex. 616 (1944) (discussing override extinguished by termination of lease, but fact question existed as to existence of special relationship of trust between lessee and override owner); Wagner v. Sheets & Walton Drilling Co., 359 S.W.2d 543 (Tex. App.—Eastland 1962, writ ref’d n.r.e.) (“We hold that there was no confidential relationship between the parties which would impress such lease with the overriding royalty with which the 1953 lease was burdened.”); Fain, 331 S.W.2d at 348 (overriding royalty burdening partially released lease does not burden new lease on released premises to party unrelated to prior lessee); Cain v. Neumann, 316 S.W.2d 915 (Tex. App.—San Antonio 1958) (discussed *infra* note 83); Keese v. Cont’l Pipe Line Co., 235 F.2d 386 (5th Cir. 1956) (overriding royalty burdening released lease does not burden new lease on same premises to same lessee when override reservation does not say otherwise, released lease contains surrender clause, and no evidence of bad faith or fiduciary duty was presented); see also Shropshire v. Hammond, 120 S.W.2d 282 (Tex. App.—Fort Worth 1938, no writ); Thomas v. Warner-Quinlan, 65 S.W.2d 321 (Tex. App.—Eastland 1933, writ ref’d); Montgomery v. Phillips Petroleum Co., 49 S.W.2d 967 (Tex. App.—Amarillo 1932, writ ref’d); Gordon v. Empire Gas & Fuel Co., 63 F.2d 487 (5th Cir. 1933); Tex. Pac. Coal & Oil Co. v. Honolulu Oil Corp., 241 F.2d 920 (5th Cir. 1957).

28. Sunac Petroleum Corp. v. Parkes, 416 S.W.2d 798 (Tex. 1967).

29. *Id.* at 804.

30. *Id.* at 799–800.

31. *Id.*

32. *Id.*

33. *Id.* at 800.

terminated and signed a new lease with the lessee of the original lease.³⁴ The lessee then stopped paying royalty to the override owner, who responded by seeking a declaratory judgment that the new lease was burdened by his overriding royalty under the extension-or-renewal clause in the assignment creating the override.³⁵

The Supreme Court of Texas first determined that the original lease had terminated for lack of production and operations because the first well was pooled for gas but only produced oil, and operations on the second well commenced after the primary term had expired.³⁶ The Court then addressed whether the new lease constituted an extension or renewal of the original lease.

An “extension” of an oil and gas lease, as the Court stated, means the “prolongation or continuation of the term of the existing lease” and “might also encompass the enlarging of the territory or strata to be covered by the lease.”³⁷ The new lease did none of those things and therefore was not an extension.³⁸ Rather, the parties entered into a new lease well after the termination of the original lease and on substantially different terms.³⁹ Specifically, the new lease did not provide for a primary term or delay rentals, unlike the original lease.⁴⁰ The new lease also contained new drilling obligations and a unique retained acreage provision.⁴¹

For similar reasons, “the new lease was not a renewal of the [original] lease”; namely, it “was executed under different circumstances, for a new consideration, upon different terms, and over a year after the expiration of the [original] lease.”⁴² The Court found it significant that the new lease was executed on a developed and producing property, unlike the original lease.⁴³ The new lease also specifically granted rights on the existing oil well to the working interest owner, and the working interest owner paid substantial value in new bonus consideration.⁴⁴ Accordingly, the overriding royalty did not burden the new lease under the assignment’s extension-or-renewal clause.⁴⁵

The Court next considered whether the overriding royalty should nevertheless be imposed on the new lease for equitable reasons.⁴⁶ The override owner cited cases from other jurisdictions to argue that the working interest owner breached its fiduciary duty by washing out the overriding

34. *Id.*

35. *Id.*

36. *Id.* at 801–02.

37. *Id.* at 802–04.

38. *Id.*

39. *Id.*

40. *Id.* at 803.

41. *Id.*

42. *Id.*

43. *Id.*

44. *Id.*

45. *Id.*

46. *Id.* at 805.

royalty and that the court should impose a constructive trust on the new lease in favor of the override owner.⁴⁷ However, the fiduciary duty imposed in these non-Texas cases was based on a close, confidential relationship between the parties,⁴⁸ or an independent contractual relationship.⁴⁹ The Court found neither of these circumstances in *Sunac*, noting that the interests of the lessee and the override owner were separated by “numerous intermediate assignments.”⁵⁰

While the *Sunac* opinion left open the possibility that a lessee may owe a fiduciary duty to its overriding royalty owners under different circumstances, it also laid the groundwork for later cases to expressly hold that an extension-or-renewal clause does not, by itself, create such a special relationship or implied duty.⁵¹ Specifically, the Court announced the following principles on the strength of Texas appellate precedent and expert commentary:

Normally, when an oil and gas lease terminates, the overriding royalty created in an assignment of the lease is likewise extinguished. It is also generally held that the assignment of an oil and gas lease reserving an overriding royalty in the assignor does not usually create any confidential or fiduciary relationship between the assignor and his assignee.⁵²

Bolstering its holding, the *Sunac* Court cited the “surrender” clause in the assignment creating the override, which provided that:

There shall be no obligation, express or implied, on the part of Assignee, its successors or assigns, to keep said lease in force by payment of rentals or drilling or development operations, and Assignee shall have the right to surrender all or any part of such leased acreage without the consent of Assignor.⁵³

47. *Id.* at 803–04.

48. *Id.*; see *Probst v. Hughes*, 286 P. 875 (Okla. 1930) (overriding royalty on prior lease burdened new lease because extension-or-renewal clause in assignment, by which plaintiff reserved overriding royalty, created confidential relationship of trust between parties; opinion notes that constructive trust may arise from attempted “washout,” but court does not impose one in this case); *Oldland v. Gray*, 179 F.2d 408, 414 (10th Cir. 1950) (“[A]ssignment of an oil and gas lease reserving an overriding royalty, and providing that such reservation shall apply to all renewals, extensions and modifications, creates a trusteeship in the assignee, his successors and assigns for oil produced from a subsequent lease.”).

49. *Howell v. Coop. Refinery Ass’n.*, 271 P.2d 271, 276 (Kan. 1954) (overriding royalty on prior lease burdened new lease based on extension-or-renewal clause in lease assignment because plaintiff and defendant were bound by contractual venture to jointly acquire leases).

50. *Sunac*, 416 S.W.2d at 804–05.

51. *Id.*

52. *Id.* at 804; see *Wagner v. Sheets & Walton Drilling Co.*, 359 S.W.2d 543 (Tex. App.—Eastland 1962, writ ref’d n.r.e.); *Thomas v. Warner-Quinlan Co.*, 65 S.W.2d 321 (Tex. App.—Eastland 1933, writ ref’d); *Brannan v. Sohio Petroleum Co.*, 260 F.2d 621 (10th Cir. 1958).

53. *Sunac*, 416 S.W.2d at 804.

This language expressly negated any special duty or relationship, even if it might have otherwise arisen between the parties.⁵⁴

2. Vega and Sasser

Subsequent cases extended the *Sunac* holding, steering Texas jurisprudence toward a general acceptance of washout transactions as a purely contractual matter. In *Exploration Co. v. Vega Oil & Gas Co.*, the Houston Fourteenth Court of Appeals used the *Sunac* Court's reasoning to hold under similar facts that replacement of the original lease, which had terminated for lack of production, did not trigger the extension-and-renewal clause protecting a previously-reserved overriding royalty, despite the lack of a surrender clause.⁵⁵ The presence of the surrender clause merely "strengthened" the basis of the *Sunac* Court's primary holding.⁵⁶

Vega established that an extension-or-renewal clause, by itself, does not create a fiduciary relationship or special obligation burdening the lessee to protect the overriding royalty owner. The *Vega* court also held that a reassignment clause in the overriding royalty reservation—a clause requiring the lease assignee to offer the override owner an opportunity to reacquire the leases if the assignee intends to let the leases expire—also does not create such a duty.⁵⁷

Shortly after *Vega*, the San Antonio Court of Appeals continued this permissive trend in *Sasser v. Dantex Oil & Gas, Inc.* by upholding a washout transaction that was, at least allegedly, specifically intended to wash out the override.⁵⁸ The two most relevant contract terms in *Sasser* are essentially the inverse of those in *Vega*: the override was subject to a surrender clause but not an extension-or-renewal clause.⁵⁹ As such, the *Sasser* court found the

54. *Id.* at 804–05; see *Fain & McGaha v. Biesel*, 331 S.W.2d 346 (Tex. App.—Fort Worth 1960, writ ref'd n.r.e.); *Montgomery v. Phillips Petroleum Co.*, 49 S.W.2d 967 (Tex. App.—Amarillo 1932, writ ref'd). Notably, the Court also disapproved of the plaintiff's estoppel theory that the overriding royalty burdened the new lease because the working interest owner continued paying the overriding royalty after the new lease was executed. *Sunac*, 416 S.W.2d at 804. The defendant made no misrepresentation by voluntarily paying the plaintiff, and the plaintiff did not rely on such payment to its detriment. *Id.* at 805.

55. *Expl. Co. v. Vega Oil & Gas Co.*, 843 S.W.2d 123 (Tex. App.—Houston [14th Dist.] 1992, writ denied).

56. *Id.* at 126. In the same year *Vega* was decided, the Fifth Circuit held in *In re GHR Energy Corp.* that a lessee "was free to terminate the leasehold estate, where the lease language expressly authorized the surrender, and to cut off [the] overriding royalties, despite the fact that gas production never ceased on the leasehold." *In re GHR Energy Corp.*, 972 F.2d 96, 100 (5th Cir. 1992). The *In re GHR Energy Corp.* court stated in dicta that it "might well reach a different result if the facts here had suggested that [the lessee] surrendered its interest in the lease to destroy the rights of the overriding royalty interest owner." *In re GHR Energy Corp.*, 979 F.2d 40, 41 (5th Cir. 1992) (per curiam). However, the Supreme Court of Texas later declined to follow the Fifth Circuit's dicta when presented with an intentional washout transaction in *Stroud and Ridge Oil*, discussed *infra* notes 68 and 97.

57. *Vega*, 843 S.W.2d at 126.

58. *Sasser v. Dantex Oil & Gas, Inc.*, 906 S.W.2d 599 (Tex. App.—San Antonio 1995, writ denied).

59. *Id.* at 601.

overriding royalty owner's case "even less compelling" than the *Sunac* plaintiff's case: not only did the assignee have the absolute right to surrender the lease, but also there was no language to serve as a contractual basis for extending the override.⁶⁰

The *Sasser* court further held that a formal written release was not necessary for the lessee to exercise the surrender clause; entering a new lease with the intent to terminate the original lease is sufficient.⁶¹ The overriding royalty owner argued that the assignee acted in bad faith by deliberately releasing the lease instead of allowing it to expire by its own terms, like in *Sunac*, but the court found this distinction immaterial.⁶² The court relied on *Sunac* for the principle that the lessee owed no fiduciary duty or obligation to act in good faith toward the overriding royalty owner.⁶³

The court also declined to impose an implied duty of good faith and fair dealing on the working interest owner in favor of the override owner, like that imposed on executive rights holders in favor of non-participating royalty owners.⁶⁴ Rather, the parties had "a purely business relationship" and the working interest owner had the "contractual right to unilaterally terminate the lease" for any reason or no reason.⁶⁵ Although the *Sasser* opinion does not reflect a specific intent by the working interest owner to destroy the overriding royalty, it strongly implies that such intent would not have obstructed this washout transaction.

The *Sasser* court also distinguished *Cain v. Neumann*—the sole outlier case in Texas that declined to enforce an attempted washout, as discussed below—because, unlike *Sasser*, the relevant contract terms in *Cain* did not contain a surrender clause.⁶⁶ The *Sasser* court also questioned whether *Cain* was still good law after *Sunac*.⁶⁷

60. *Id.* at 606.

61. *Id.* at 605–07.

62. *Id.*

63. *Id.*

64. *Id.* at 607.

65. *Id.* at 602, 607.

66. *Id.* at 607; see *Cain v. Neumann*, 316 S.W.2d 915 (Tex. App.—San Antonio 1958, no writ) (discussed *infra* note 83). This distinction is arguably at odds with the *Vega* holding, which held that presence of the surrender clause was not dispositive, but merely supported the principal holding that the lessee had no special duty toward the override owner. Compare *Cain*, 316 S.W.2d at 920, with *Expl. Co. v. Vega Oil & Gas Co.*, 843 S.W.2d 123 (Tex. App.—Houston [14th Dist.] 1992, writ denied). Further, the *Cain* opinion does not appear to support this distinction, stating that "even if there were an express surrender clause, non-production must be the fact, not a mere recital." *Cain*, 316 S.W.2d at 919. *Cain* can be more convincingly distinguished from *Sasser* on the grounds that it involved owners of co-equal working interests, neither of which had the power to surrender or release the other's interest; an overriding royalty interest, on the other hand, is directly tied to the working interest that it burdens. *Id.*

67. *Sasser*, 906 S.W.2d at 607.

3. Stroud Production v. Hosford

The Houston First Court of Appeals recently faced yet another washout mutation in *Stroud Production, L.L.C. v. Hosford*.⁶⁸ The lessee and operator of the original lease in *Stroud* elected not to repair mechanical failures on the sole producing well on the lease.⁶⁹ Instead, it allowed the lease to terminate for lack of production, took new leases on the property, and restored the well to production.⁷⁰ The lessee stopped paying the owners of the overriding royalty that burdened the original leases, who brought suit with a variety of theories for relief, including “intentional termination” of their interests.⁷¹ The assignments creating the overrides did not contain extension-or-renewal clauses, and the overrides were not subject to a surrender clause.⁷² At trial, the jury found that the lessee’s actions were intended, at least in part, to destroy the overriding royalties.⁷³ The plaintiffs were awarded damages on several of their claims.⁷⁴

After an expansive review of Texas cases, the court reversed on grounds that:

[N]o Texas court has yet recognized that a lessee generally owes any type of duty, whether it be an implied contractual covenant or a fiduciary-type duty, to protect the interest of an overriding royalty interest holder so as to require the lessee to make repairs to well equipment, perpetuate the lease, and ensure that such overriding interests are not extinguished.⁷⁵

Leaning on the lack of an extension-or-renewal clause, the court likewise found no basis for recognizing such a duty in *Stroud*.⁷⁶ The court cited *Vega* for the principle “that the absence of a surrender clause, even when there is also a renewals and extensions clause, does not result in the creation of a fiduciary relationship.”⁷⁷ Noting numerous intervening assignments, the court also found “no evidence of any special relationship of trust and confidence between” the parties.⁷⁸

Abstracting the interpretive principles from its review of precedent, the *Stroud* court remarked that prior Texas holdings “indicate that the existence

68. See *Stroud Prod., L.L.C. v. Hosford*, 405 S.W.3d 794 (Tex. App.—Houston [1st Dist.] 2013, pet. denied).

69. *Id.* at 799–800.

70. *Id.* at 800.

71. *Id.* at 797–98.

72. *Id.* at 810.

73. *Id.* at 800–01.

74. *Id.* at 801.

75. *Id.* at 809.

76. *Id.* at 810.

77. *Id.*; see *Expl. Co. v. Vega Oil & Gas Co.*, 843 S.W.2d 123, 124, 126 (Tex. App.—Houston [14th Dist.] 1992, writ denied).

78. *Stroud*, 405 S.W.3d at 809.

and scope of any duty owed by a lessee to the holder of an overriding royalty interest is an open question under Texas law,” but:

[T]hese opinions direct us to carefully consider the language of controlling documents and the circumstances and relationships of the parties to determine whether any such duty is owed and, thus, whether any actionable wrong has been committed by a lessee who seeks to “intentionally terminate” a lease so as to divest the holder of an overriding royalty interest of his interest.⁷⁹

The court seemed to stop short of directly holding that intentional termination of an overriding royalty is simply not a recognized cause of action in Texas, though the lessee vigorously argued for such a holding. Among the other claims rejected in *Stroud* were breach of contract, conversion, conspiracy, tortious interference with contract rights, breach of duty of good faith and fair dealing, fraudulent concealment, and breach of implied covenant to develop.⁸⁰ Notably, however, the *Stroud* dissent found support for the override owners’ claim of tortious interference in certain clauses in the original lease.⁸¹

Just as *Sasser* is the inverse of *Vega*⁸² as to the two most relevant contract terms to an override washout transaction—the surrender clause and the extension-or-renewal clause—*Stroud* is likewise the inverse of *Sunac*, as demonstrated in the following chart:

	ER Clause	No ER Clause
Surrender Clause	<i>Sunac</i>	<i>Sasser</i>
No Surrender Clause	<i>Vega</i>	<i>Stroud</i>

Taken together, these four cases represent the Texas appellate courts’ rejection of challenges to override washout transactions under every possible combination of the two most relevant contract terms. Of course, each of these cases is unique and involves facts not present in the others. The cases differ significantly as to evidence of bad faith actions by the lessee and the productiveness of the original lease, for example. However, the utter consistency with which Texas courts have validated override washout transactions is a high bar to clear for any litigants hoping for a different result.

79. *Id.* at 806.

80. *Id.* at 797, 800.

81. *Id.* at 818–21.

82. *See Sasser v. Dantex Oil & Gas, Inc.*, 906 S.W.2d 599, 601 (Tex. App.—San Antonio 1995, writ denied).

B. Working Interest Washouts

The legal principles governing an overriding royalty washout are largely the same as a non-operating working interest washout, with three key differences. First, partial assignments of working interest do not commonly contain anti-washout clauses, unlike assignments and reservations of overrides. Second, working interests give their owners the ability to extend their own interest by drilling and producing their own wells, unlike overriding royalties. Third, a working interest owner does not have the authority to release its cotenant's working interest, whereas overriding royalties automatically co-terminate upon release of their associated working interest. These differences and their impact on Texas law are illustrated in the following cases.

1. Cain v. Neumann

The first reported Texas case to address the effectiveness of a working interest washout transaction appears to be *Cain v. Neumann* in 1958.⁸³ *Cain* involved a 3,100-acre mineral lease with a primary term of twenty-five years, which was to continue in force for so long "as oil, gas or other minerals can be produced in paying quantities thereon."⁸⁴ The lease was widely assigned and subdivided. By several partial assignments, Columbia Southern Chemical Corporation came to own all of the salt rights in the entire lease.⁸⁵ Ownership of the remaining mineral rights in the lease, such as oil, gas, and coal, was divided between several parties and differed from tract to tract.⁸⁶

Shortly before expiration of the primary term, the only mineral production on the lease was from Columbia Southern's salt extraction operations.⁸⁷ Columbia Southern agreed with the lessors to release and surrender its interest in the original lease in exchange for a new lease covering only the salt rights with a different royalty obligation.⁸⁸ The lessors sued Cain and other remaining lease owners in a trespass to try title action, alleging that Columbia Southern's release effected a termination of the entire original lease.⁸⁹ Specifically, the lessors argued the ongoing salt production could not perpetuate the original lease because it no longer covered the salt rights.⁹⁰

The court disagreed, holding that the lessor and Columbia Southern could not, "by an agreement between themselves, release and destroy the

83. See *Cain v. Neumann*, 316 S.W.2d 915 (Tex. App.—San Antonio 1958, no writ).

84. *Id.* at 917.

85. *Id.*

86. *Id.*

87. *Id.*

88. *Id.*

89. *Id.* at 916–17.

90. *Id.* at 919.

rights of third persons who owned under the [original] lease.”⁹¹ The special limitation in the original lease—cessation of commercial production of minerals from the leased premises—was not conditioned on whether the original lease continued to cover those minerals. As the court stated: “To argue that appellants did not own the mineral being produced [at the time of release] is irrelevant to the test stated in the [original] lease. That lease imposes no such requirement. Ownership of the mineral is smuggled into the proposition by argument.”⁹² In other words, Cain and the remaining lease owners had the right to rely on the terms of the original lease as written; Columbia Southern’s release of the salt rights did not amend those terms, impliedly or otherwise.

The original lease in *Cain* did not contain a “surrender” clause,⁹³ though this fact did not appear to play a role in the court’s holding: “[E]ven if there were an express surrender clause, non-production must be the fact, not a mere recital.”⁹⁴ This is consistent with most subsequent Texas cases that likewise did not view the presence of a surrender clause as dispositive.⁹⁵

The *Cain* majority opinion drew a dissent, which favored the argument that “there was no production on that part of the [original] lease which had not been surrendered, and therefore the [original] lease terminated by its own provisions.”⁹⁶ In other words, the dissent believed that salt could not be produced “thereon,” meaning on or from the original lease, because the original lease no longer covered or contained the salt estate.

2. Ridge Oil v. Guinn Investments

The Texas Supreme Court relied on *Sasser* and *Sunac* as the basis for its holding in *Ridge Oil Co. v. Guinn Investments, Inc.*⁹⁷ *Ridge Oil* involved an oil and gas lease that had been subdivided into two large tracts: one owned by Ridge and the other owned by Guinn.⁹⁸ The entire lease was being held by production from wells located solely on Ridge’s tract; Guinn’s tract had no production.⁹⁹ The lease’s habendum clause provided that it would remain in force as long as oil or gas is “produced from said land by the lessee.”¹⁰⁰

91. *Id.* at 918.

92. *Id.* at 920.

93. *Id.*

94. *Id.* at 919.

95. See *Ridge Oil Co. v. Guinn Invs., Inc.*, 148 S.W.3d 143, 152–55 (Tex. 2004); *Stroud Prod., L.L.C. v. Hosford*, 405 S.W.3d 794, 807, 810 (Tex. App.—Houston [1st Dist.] 2013, pet. denied); *Expl. Co. v. Vega Oil & Gas Co.*, 843 S.W.2d 123, 126 (Tex. App.—Houston [14th Dist.] 1992, writ denied). *But see Sasser v. Dantex Oil & Gas, Inc.*, 906 S.W.2d 599, 607 (Tex. App.—San Antonio 1995, writ denied).

96. *Cain*, 316 S.W.2d at 923.

97. *Ridge Oil*, 148 S.W.3d 143.

98. *Id.* at 147.

99. *Id.*

100. *Id.* at 147–48.

Ridge offered to purchase Guinn's tract, which Guinn declined.¹⁰¹ Ridge then contacted certain of the lessors, proposing to:

[T]ake new oil and gas leases covering only [the Ridge tract] and to simply shut the two [Ridge tract] wells in for a period of 90 days which would terminate the [original] oil and gas lease. We could then take new oil and gas leases from the mineral owners under the [Guinn tract].¹⁰²

In other words, Ridge planned to wash out Guinn's working interest by deliberately stopping production from its wells to terminate the lease and acquiring new leases on both tracts. Ridge followed through on its plan and Guinn sued for a judicial declaration that the original lease had not terminated or, alternatively, that Guinn owned a working interest in the new leases.¹⁰³ Guinn also brought an alternative claim for damages based on fraud and tortious interference.¹⁰⁴

Guinn argued that the temporary cessation of production doctrine applied to save the lease, offering cases in which leases had survived for periods of non-production far longer than in this case.¹⁰⁵ The Court disagreed, holding that cessation of production from the original lease was necessarily permanent when Ridge acquired new leases on its tract.¹⁰⁶ As in *Sasser*, execution of the new leases impliedly released the original lease as to Ridge's tract, on which the wells were located.¹⁰⁷ At that point, the wells ceased producing from the original lease and began producing exclusively from the new leases.¹⁰⁸ Without any other operations or production to perpetuate it, Guinn's lease tract terminated soon thereafter.¹⁰⁹

Guinn cited *Cain* to argue that production from Ridge's wells continued to perpetuate the original lease because they were still producing from "said land," meaning the land originally described in the original lease.¹¹⁰ As in *Cain*, the original lease required that oil and gas be produced from the land described in the lease; it did not require that the land and minerals, or the production therefrom, continue to be subject to the lease or owned by the lessee.¹¹¹ The Court again disagreed, noting that the original lease in *Ridge Oil* additionally required that the oil and gas be produced "by the lessee."¹¹²

101. *Id.* at 148.

102. *Id.*

103. *Id.* at 149.

104. *Id.* at 147.

105. *Id.* at 149.

106. *Id.* at 151–53.

107. *Id.* Because the lease replacement caused the permanent cessation of production, Ridge arguably could have achieved the same result without shutting in the wells at all.

108. *Id.* at 152.

109. *Id.* at 153.

110. *Id.* at 155.

111. *Id.* at 155–56.

112. *Id.* at 147–48.

When Ridge, the sole owner and operator of the producing wells, replaced its portion of the original lease, it ceased to be a lessee under the original lease, so Ridge's production thereafter did not qualify to perpetuate the original lease.¹¹³

Guinn urged the Court to hold that a lessee cannot surrender or terminate a lease with the specific intent to destroy the rights of another owner of an interest in the lease.¹¹⁴ The Court reviewed the holdings in *Sasser* and other washout cases, which consistently held that a lessee is generally free to agree with its lessor to replace its lease, whether or not the lease contains a surrender clause.¹¹⁵ Precedent also consistently declined to impose any special duty on a lessee to protect the interest of its override owners.¹¹⁶ While such a duty might make sense in the case of a washed-out overriding royalty owner, who has no development rights and is completely dependent on the lessee, it is inappropriate for the sole working interest owner in a large lease tract like Guinn, which had every opportunity to drill its own well.¹¹⁷

As such, the Court declined to deviate from precedent and held that Ridge lawfully replaced its portion of the lease, Guinn's lease tract had consequently terminated, and Ridge owed no special duty to Guinn as a co-equal cotenant in the lease:

Ridge owed no duty to the owners of the possibility of reverter of the mineral interest in the Guinn tract to continue the [original] lease in effect. Nor did Ridge owe any duty to Guinn . . . to continue the [original] lease in effect. The owners of the Ridge tract and the working interest owner of the Ridge tract were free to mutually agree to terminate the [original] lease as to their respective interests. It is immaterial that a collateral effect of that agreement was that the only producing wells permanently ceased to be produced "by a lessee" under the [original] lease, and because there was no other production on the lands described in the [original] lease, that lease terminated by its own terms.¹¹⁸

The Court relied upon its prior holding in *Sunac* in rejecting Guinn's plea for a constructive trust in Ridge's new leases.¹¹⁹ As in *Sunac*, the plaintiff presented no evidence of a relationship of trust or confidence between Ridge and Guinn that would support this equitable remedy; Guinn was not even the beneficiary of an extension-or-renewal clause.¹²⁰ In the same breath, the Court also summarily dismissed Guinn's fraud and tortious

113. *Id.*

114. *Id.* at 155.

115. *Id.* at 153.

116. *Id.* at 155, 161.

117. *Id.* at 155.

118. *Id.*

119. *Id.* at 160-61.

120. *Id.*

interference claims because Ridge had made no relevant misrepresentations nor induced the breach of any of Guinn's contract rights.¹²¹

Ridge Oil is notable for the operating lessee's written admission of intent to wash out Guinn, who argued vehemently that this intent distinguished its case from prior washout cases.¹²² However, as in *Stroud*, the lessor's intent appears to be irrelevant without a substantiated cause of action, which is yet to be found in any Texas washout case.¹²³

C. Washouts in Other Jurisdictions

A majority of states with reported cases on point have followed the Texas approach to washouts and have generally declined to grant equitable relief to washout targets or impose a special duty on the lessee, absent specific contract language to the contrary. These states appear to include Arkansas,¹²⁴ California,¹²⁵ Colorado,¹²⁶ Kentucky,¹²⁷ Louisiana,¹²⁸ Michigan,¹²⁹ North Dakota,¹³⁰ Utah,¹³¹ and Wyoming.¹³²

121. *Id.*

122. *Id.* at 148, 155.

123. *Id.*; see *Stroud Prod., L.L.C. v. Hosford*, 405 S.W.3d 794, 803–04, 811 (Tex. App.—Houston [1st Dist.] 2013, pet. denied).

124. See *Henry v. Gulf Refin. Co.*, 15 S.W.2d 979, 984 (Ark. 1929).

125. See *La Laguna Ranch Co. v. Dodge*, 114 P.2d 351, 354 (Cal. 1941).

126. See *Degenhart v. Gold King Petroleum Corp.*, 851 P.2d 304, 306 (Colo. App. 1993); *James Barlow Fam. Ltd. P'ship v. David M. Munson, Inc.*, 132 F.3d 1316 (10th Cir. 1997); *Shewmake v. Badger Oil Corp.*, 654 F. Supp. 1184, 1187 (D. Colo. 1987). *But see* *Oldland v. Gray*, 179 F.2d 408 (10th Cir. 1950).

127. See *Goocey v. Hopkins*, 266 S.W. 1087, 1088 (Ky. 1924); *S.W. Bardill, Inc. v. Bird*, 346 S.W.2d 25, 26 (Ky. 1961).

128. See *Avatar Expl. v. Chevron U.S.A., Inc.*, 933 F.2d 314, 318–19 (5th Cir. 1991); *Berman v. Brown*, 70 So.2d 433, 438 (La. 1954); *CLK Co. v. CXY Energy, Inc.*, 972 So.2d 1280, 1291 (La. Ct. App. 2007). *But see* *Frankel v. Exxon Mobil Corp.*, 923 So.2d 55 (La. Ct. App. 2005); *Robinson v. N. Am. Royalties, Inc.*, 463 So.2d 1384, 1386 (La. Ct. App. 1985).

129. See *Thomas v. Whyte*, 146 N.W.2d 721, 722–23 (Mich. Ct. App. 1966).

130. See *Pitchblack Oil, LLC v. Hess Bakken Invs. II, LLC*, 949 F.3d 424, 428–29 (8th Cir. 2020).

131. See *Heiner v. S.J. Groves & Sons Co.*, 790 P.2d 107, 110 (Utah Ct. App. 1990).

132. See *Questar Expl. & Prod. Co. v. Rocky Mountain Res., LLC*, 388 P.3d 523, 531 (Wyo. 2017); *Sawyer v. Guthrie*, 215 F. Supp. 2d 1254, 1260–62 (D. Wyo. 2002). *But see* *Mimi Corp. v. Hill*, 310 F.2d 467 (10th Cir. 1962).

A minority of states have held otherwise on various grounds, including Kansas,¹³³ Mississippi,¹³⁴ Oklahoma,¹³⁵ and Pennsylvania,¹³⁶ though exception cases can be found in most of those states. New Mexico is arguably a minority jurisdiction, though most of its cases finding a special relationship have been based on independent contract obligations.¹³⁷

IV. *TRO-X* V. *ANADARKO*: A FRESH APPLICATION OF OLD RULES

The Supreme Court of Texas reaffirmed its strict construction standard for anti-washout clauses in *TRO-X, L.P. v. Anadarko Petroleum Corp.* in 2018.¹³⁸ The essential legal question in *TRO-X* is fundamentally the same as that in *Sunac*: whether the particular language in an anti-washout clause applies when the operating lessor replaced the original leases with new leases.¹³⁹ *TRO-X* had assigned a set of oil and gas leases to Anadarko's predecessor-in-interest, reserving an option to receive a re-assignment or "back-in" of 5% working interest in the original leases after Anadarko recouped its development expenses for certain drilling obligations.¹⁴⁰

The assignment contained an anti-washout clause, stating that the back-in option "shall extend to and be binding upon any renewal(s), extension(s), or top lease(s) taken within one (1) year of termination of the underlying interest."¹⁴¹ A well was drilled on an adjacent tract that triggered the original leases' "offset well" clause, which required Anadarko to release the affected portion of the original leases if it failed to timely drill an offset well.¹⁴² Anadarko failed to do so, acquired new leases on the affected portion,

133. See *Campbell v. Nako Corp.*, 402 P.2d 771, 777–79 (Kan. 1965); *Howell v. Coop. Refinery Ass'n*, 271 P.2d 271, 275–76 (Kan. 1954); *Reynolds-Rexwinkle Oil, Inc. v. Petex, Inc.*, 1 P.3d 909, 915–16 (Kan. 2000). But see *Lillibridge v. Mesa Petroleum Co.*, 1987 U.S. Dist. LEXIS 17067, at *5–9 (D. Kan., Mar. 26, 1987); *Gilroy v. White Eagle Oil Co.*, 201 F.2d 113, 116–17 (10th Cir. 1952); *K & E Drilling, Inc. v. Warren*, 340 P.2d 919, 923–24 (Kan. 1959).

134. See *Gill v. Gipson*, 982 So.2d 415, 419–22 (Miss. Ct. App. 2007). But see *Whitten v. Daws*, 83 So.2d 744, 746 (Miss. 1955).

135. See *Rees v. Briscoe*, 315 P.2d 758, 762–64 (Okla. 1957); *Indep. Gas & Oil Producers, Inc. v. Union Oil Co. of Cal.*, 669 F.2d 624 (10th Cir. 1982); *Probst v. Hughes*, 286 P. 875, 877–79 (Okla. 1930). But see *Cities Serv. Oil Co. v. Sohio Petroleum Co.*, 345 F. Supp. 28, 30 (W.D. Okla. 1972); *Thornburgh v. Cole*, 207 P.2d 1096, 1098–99 (Okla. 1949); *Brannan v. Sohio Petroleum Co.*, 260 F.2d 621, 623 (10th Cir. 1958); *Olson v. Cont'l Res., Inc.*, 109 P.3d 351, 355 (Okla. Ct. App. 2004); *Hawkins v. Klein*, 255 P. 570, 574 (Okla. 1928); *ENI Producing Props. Program Ltd. P'ship v. Samson Inv. Co.*, 977 P.2d 1086, 1088–99 (Okla. 1999).

136. See *Stone v. Marshall Oil Co.*, 41 A. 748, 750 (Pa. 1898); *Cole v. Phila. Co.*, 26 A.2d 920, 923–24 (Pa. 1942).

137. See *Phillips Petroleum Co. v. McCormick*, 211 F.2d 361, 364–65 (10th Cir. 1954); *Jack v. Hunt*, 410 P.2d 403, 409–11 (N.M. 1966). But see *Skaggs v. Conoco, Inc.*, 957 P.2d 526, 529–31 (N.M. Ct. App. 1998); *Kutz Canon Oil & Gas Co. v. Harr*, 244 P.2d 522, 539 (N.M. 1952).

138. *TRO-X, L.P. v. Anadarko Petroleum Corp.*, 548 S.W.3d 458, 462 (Tex. 2018).

139. See *id.* at 459; *Sunac Petroleum Corp. v. Parkes*, 416 S.W.2d 798, 799 (Tex. 1967).

140. *TRO-X*, 548 S.W.3d at 460.

141. *Id.*

142. *Id.*

and released the original leases as to the affected portion.¹⁴³ The new leases did not contain a “top lease” clause or other language subordinating them to the original leases, nor did they reference the original leases at all.¹⁴⁴

TRO-X approached Anadarko to confirm that its back-in option applied to the new leases, which Anadarko denied.¹⁴⁵ In the litigation, TRO-X argued that the new leases were top leases and, therefore, subject to the anti-washout clause and the back-in option because the new leases were executed while the original leases were still in effect and the new leases did not express the parties’ intent to terminate the original leases.¹⁴⁶ Anadarko argued that the new leases were not top leases because they were not contingent on termination of the original leases, as is typical of a top lease.¹⁴⁷

The Court agreed with Anadarko, noting that a top lease is defined as a subsequent lease that is “subject to a valid, subsisting prior lease.”¹⁴⁸ Citing *Ridge Oil*, the Court held that “an existing lease between the parties as to an interest terminates when the parties enter into a new lease covering that interest *unless* the new lease objectively demonstrates that both parties intended for the new lease not to terminate the prior lease between them.”¹⁴⁹ In other words, to be a top lease, the lease itself must contain language “making it subject or subordinate to the prior lease, or restricting the new lease’s grant or limiting the grant to a different interest from that conveyed by the prior lease.”¹⁵⁰

The Court further held that TRO-X, as the plaintiff and claimant, had the burden of proving that the parties did not intend for the new leases to terminate the original leases, and absent an ambiguity in the relevant language, extrinsic evidence is inadmissible to show such intent.¹⁵¹ The Court saw no relevance in whether the new leases were executed before or after the release of the original leases, or in the presence or lack of a surrender clause.¹⁵² In fact, the surrender clause was so irrelevant to the Court’s analysis that the opinion does not even discuss it.¹⁵³

TRO-X likely believed that it had protected itself from the harsh results in *Sunac* by including “top lease(s)” in its anti-washout clause, but the Court’s view of what constitutes a top lease was narrower than merely a lease executed before release of the original lease. The takeaway lesson for practitioners is similar to that in *Sunac*, which is to draft your anti-washout

143. *Id.* at 459–60.

144. *Id.* at 461.

145. *Id.*

146. *Id.*

147. *Id.* at 462.

148. *Id.* (quoting *BP Am. Prod. Co. v. Laddex, Ltd.*, 513 S.W.3d 476, 478 n.1 (Tex. 2017)).

149. *Id.* at 463..

150. *Id.* at 464.

151. *Id.* at 464–65.

152. *Id.* at 464.

153. *Id.*

clauses to broadly cover all possible forms and mutations of new rights and interests in the leasehold or mineral estates acquired by the lessee or its affiliates.¹⁵⁴ This should include any and all forms of: (1) extensions, renewals, replacements, substitutions, exchanges, successors, amendments, modifications, ratifications, or revivors of the original lease;¹⁵⁵ (2) new leases or top leases on any part of the mineral interest covered by the original lease;¹⁵⁶ and (3) fee interests in any of the mineral or royalty estates covered by the original lease.¹⁵⁷

V. *CIMAREX V. ANADARKO*: A WASHOUT INSTRUCTION MANUAL

A. *The Case*

Prior to *Cimarex Energy Co. v. Anadarko Petroleum Corp.*,¹⁵⁸ the only major cases to address washout of a working interest cotenant were *Ridge Oil* and *Cain*.¹⁵⁹ *Cimarex* is not a classic washout case—in fact, *Cain* is the only washout case cited in the opinion.¹⁶⁰ Further, the operating lessee compelled the termination of its cotenant's working interest without surrendering its own,¹⁶¹ establishing a washout transaction even simpler and safer than the cases discussed above.

The central legal question in *Cimarex* was whether an operating lessee's drilling and production activities perpetuated a non-operating cotenant's lease when the non-operating cotenant was not allowed to financially participate in those activities.¹⁶² Answering in the negative, the El Paso Court

154. See *Macquarie Bank Ltd. v. Knickel*, 723 F. Supp. 2d 1161 (D.N.D. 2010) (holding that affiliate of operator who took new leases was subject to anti-washout clause).

155. See *WILLIAMS & MEYERS*, *supra* note 13, at § 428.1; *Crimson Expl., Inc. v. Magnum Producing L.P.*, No. 13-15-00013-CV, 2017 Tex. App. LEXIS 12068, 2017 WL 6616740 (Tex. App.—Corpus Christi 2017, pet. denied) (involving back-in working interest owner that successfully enforced anti-washout clause attached to stipulated definition of lease extension); *EOG Res., Inc. v. Hanson Prod. Co.*, 94 S.W.3d 697 (Tex. App.—San Antonio 2002, no pet.) (override owner successfully enforced anti-washout clause attaching to extensions and renewals).

156. See *Miles & Benavides*, *supra* note 13, at 1061–62; *Otter Oil Co. v. Exxon Co., U.S.A.*, 834 F.2d 531 (5th Cir. 1987) (overriding royalty owner successfully enforced anti-washout clause expressly covering new leases); see also *Ultra Res., Inc. v. Hartman*, 226 P.3d 889 (Wyo. 2010) (holding that new federal lease qualified as “replacement” lease under anti-washout clause and was therefore subject to net profits interest in prior surrendered lease).

157. See *In re GHR Energy Corp.*, 972 F.2d 96, 100 (5th Cir. 1992); see also *Lonabaugh v. Midwest Refiin. Co.*, 285 F. 63, 67 (D. Wyo. 1922).

158. See *Cimarex Energy Co. v. Anadarko Petroleum Corp.*, 574 S.W.3d 73 (Tex. App.—El Paso 2019, pet. denied).

159. *Ridge Oil Co. v. Guinn Invs., Inc.*, 148 S.W.3d 143, 153–55 (Tex. 2004); *Cain v. Neumann*, 316 S.W.2d 915 (Tex. App.—San Antonio 1958, no writ).

160. *Cimarex*, 574 S.W.3d at 93 n.10. This is not surprising. *Cimarex* likely did not cite washout cases because, other than *Cain*, courts generally do not favor *Cimarex*'s position. *Anadarko* may have avoided citing washout cases to avoid any negative association with that pejorative term.

161. *Id.* at 95–96.

162. *Id.* at 85–86.

of Appeals gave operators an instruction manual for washing out non-operating leases.

Cimarex owned a paid-up oil and gas lease covering 1/6 of the mineral interest in a tract.¹⁶³ Anadarko owned the leases collectively covering the remaining 5/6.¹⁶⁴ Anadarko also acquired top leases from Cimarex's lessors on the tract.¹⁶⁵ Cimarex's lease had a typical habendum clause: the lease would remain in effect for the primary term and "as long thereafter as oil or gas is produced from said land."¹⁶⁶ It also had a typical royalty clause: "The royalties to be paid by Lessee are . . . 1/4 of that produced and saved from said land"¹⁶⁷

During the primary term of Cimarex's lease, Anadarko drilled and completed two wells on the tract.¹⁶⁸ Cimarex asked Anadarko to let it participate in the wells and proposed a joint operating agreement, both of which Anadarko declined.¹⁶⁹ Cimarex also requested an accounting of the wells in order to determine the amount of royalty it owed its lessors.¹⁷⁰ After brief litigation over the accounting, Cimarex and Anadarko entered a settlement agreement in which Anadarko agreed to pay Cimarex its share of production revenue from the wells, less its share of drilling, completion, and operating costs.¹⁷¹ Both parties agreed to be responsible for paying their own lease royalties.¹⁷² Anadarko stopped paying Cimarex at the end of the primary term of Cimarex's lease, alleging that it had terminated for failure to produce hydrocarbons and that Anadarko's top leases had therefore become effective.¹⁷³ Cimarex sued Anadarko for breach of the settlement agreement.¹⁷⁴

Cimarex argued that its lease was still in effect because production from Anadarko's wells perpetuated Cimarex's lease into the secondary term.¹⁷⁵ Cimarex further argued that it had agreed with Anadarko to participate in Anadarko's wells under the settlement agreement, which acted like a joint operating agreement.¹⁷⁶ Finally, Cimarex argued that its lessors were estopped from arguing that Cimarex's lease had terminated because it had

163. *Id.* at 80.

164. *Id.*

165. *Id.*

166. *Id.* at 81 (quoting *Anadarko Petroleum Corp. v. Thompson*, 94 S.W.3d 550, 554 (Tex. 2002)).

167. Petition for Review and Appendix, Tab 7, *Cimarex Energy Co. v. Anadarko Petroleum Corp.*, 547 S.W.3d 73 (Tex. App.—El Paso 2019, pet. denied) (No. 19-0324), <https://search.txcourts.gov/SearchMedia.aspx?MediaVersionID=4569eb91-0e13-499f-9e4d-feb78da806ae&coa=cossup&DT=BRIEFS&MediaID=236a4804-363e-41c6-856e-435a80f974a7>.

168. *Cimarex*, 574 S.W.3d at 81.

169. *Id.* at 82.

170. *Id.*

171. *Id.* at 83–84.

172. *Id.* at 84.

173. *Id.*

174. *Id.*

175. *Id.* at 85.

176. *Id.*

accepted royalty on production from Anadarko's wells, and as the lessor's successor-in-interest under the top leases, Anadarko was likewise estopped.¹⁷⁷

Anadarko countered that "Cimarex's lease required Cimarex to directly cause production . . . in order to extend the lease [into] the secondary term" and could not rely on Anadarko's operations.¹⁷⁸ Anadarko also argued that the settlement agreement merely addressed the accounting owed to Cimarex as a non-participating mineral cotenant and that the royalty obligation under Cimarex's lease had no bearing on the habendum clause.¹⁷⁹

The El Paso Court of Appeals held for Anadarko, relying mainly on its prior holding in *Hughes v. Cantwell* for the principle that one lessee's operations will not perpetuate the separate lease of another lessee who does not participate in such operations.¹⁸⁰ In *Hughes*, a non-operating lease owner failed to pay an annual delay rental payment, relying instead on his working interest cotenant's drilling to perpetuate his own lease, even though the non-operating lease owner declined the cotenant's invitation to participate.¹⁸¹ The *Hughes* court disapproved, holding that the non-operating lease required its owner to actively "do something to bring about that exploration and production," either "personally or constructively."¹⁸² Despite the passive verb voice in the rentals clause—"[i]f operations for drilling [were] not commenced on said land"—which is grammatically agnostic about who brings about the drilling, the *Hughes* court gave more weight to the lease's "stated purpose" of achieving drilling and production.¹⁸³

The court similarly held that the habendum clause of Cimarex's lease required it "to be the one to cause production," also despite the clause's passive verb voice: "[A]s long thereafter as oil or gas is produced from said land"¹⁸⁴ Applying *Hughes*, the court based this finding of implied intent on the lease's stated purpose of establishing production and several active-voice lease clauses requiring direct action by the lessee, like the requirements to pay royalty and commence operations under savings clauses.¹⁸⁵

Cimarex argued that *Hughes* is distinguishable because the relevant clause in the Cimarex lease was a "thereafter" habendum clause, not an "unless" delay rentals clause.¹⁸⁶ The court rejected this distinction, citing

177. *Id.* at 90–100.

178. *Id.* at 84.

179. *Id.*

180. *Id.* at 90–91 (citing *Hughes v. Cantwell*, 540 S.W.2d 742 (Tex. App.—El Paso 1976, writ ref'd n.r.e.)).

181. *Id.*

182. *Id.* at 91 (quoting *Hughes*, 540 S.W.2d at 744).

183. *Id.* at 90 (quoting *Hughes*, 540 S.W.2d at 743) (emphasis added).

184. *Id.* at 90, 92 (emphasis added).

185. *Id.* at 91.

186. *Id.* at 92.

Fifth Circuit precedent.¹⁸⁷ Cimarex also attempted to distinguish *Hughes* on the grounds that Cimarex repeatedly requested to participate in Anadarko's wells, unlike the non-operating lease owner in *Hughes*.¹⁸⁸ The court disagreed on the grounds that Anadarko owed no duty to allow Cimarex to participate under Texas cotenancy law.¹⁸⁹ Cimarex also relied on *Cain v. Neumann* as an example of a lease being perpetuated by a cotenant's production on the same land under a separate lease.¹⁹⁰ The court distinguished *Cain* on the grounds that both cotenants in that case owned interests in the same lease, not in different leases on the same property.¹⁹¹

Cimarex pointed out that the habendum and royalty clauses in its lease use the same passive term—"produced"—to define the lessee's obligations thereunder and argued that the term should be construed similarly in both instances.¹⁹² Specifically, because the lessors accepted royalty on Cimarex's 1/6 share of oil and gas produced from Anadarko's wells, they must admit that oil and gas was likewise produced for habendum clause purposes and the lease thereby extended.¹⁹³ Inversely, if Cimarex's lease was not perpetuated by oil and gas produced from operations in which it did not participate, then the court cannot hold that royalty is payable on oil and gas produced under the royalty clause.¹⁹⁴ Yet the court did just that:

[A] lessor has the right to impose additional or different requirements on a lessee to keep a lease alive during the primary term, in contrast to those imposed in the secondary term. . . . Thus, there is nothing inherently contradictory with a lessor requiring a lessee to make royalty payments on a co-tenant's production during the primary term of a lease—particularly where the primary term is paid-up—while at the same time requiring the lessee to cause its own production on the subject property in order to extend the lease into a secondary term, where there is no cash consideration paid.¹⁹⁵

In other words, the parties are free to agree that royalty is payable on all production by any party, but only the lessee's active or constructive production will perpetuate the lease. The court further reasoned that if Cimarex were not required to cause its own production to extend the lease,

187. *Id.* at 93 (citing *Mattison v. Trotti*, 262 F.2d 339, 340 (5th Cir. 1959)).

188. *Id.* at 95 (citing *Hughes*, 540 S.W.2d at 743).

189. *Id.*

190. *Id.* at 93 n.10 (discussing *Cain v. Neumann*, 316 S.W.2d 915 (Tex. App.—San Antonio 1958, no writ)).

191. *See id.*

192. *Id.* at 90, 94; *see supra* text accompanying notes 166 and 167 (quoting the habendum and royalty clauses).

193. *Cimarex*, 574 S.W.3d at 90, 94.

194. *Id.*

195. *Id.* at 94 (citation omitted). Although it may not have intended to do so, the court appears to incorrectly state that royalty payments are necessary to maintain the lease during the primary term. *See Hitzelberger v. Samedan Oil Corp.*, 948 S.W.2d 497, 505 (Tex. App.—Waco 1997, writ denied).

then the secondary term would be superfluous because Cimarex's obligations thereunder would be identical to those in the primary term.¹⁹⁶

The court rejected Cimarex's argument that the settlement agreement acted as a joint operating agreement by which Cimarex retroactively participated in drilling the wells, noting that the settlement agreement did not allocate any risk to Cimarex and specifically described Cimarex as a "non-participating co-tenant."¹⁹⁷ The court also rejected Cimarex's argument that by accepting royalty from Cimarex, the lessors—and Anadarko as the lessors' successor under the top leases—were estopped from claiming that the Cimarex lease had terminated, citing its prior holding that royalty is due on all production regardless of who caused it and noting that the lessors only accepted royalty in the primary term, not the secondary term.¹⁹⁸ Finally, the court rejected Cimarex's argument that forcing a non-operating lease owner to drill its own well violates public policy by discouraging joint development, particularly when doing so would be financially untenable and when the non-operating lease owner is willing and able to participate.¹⁹⁹

B. Some Critiques

Regardless of the merits of the *Cimarex* holding, its practical effect is clear: the case provides operators with a simple and effective method for washing out a non-operating lease by merely declining the owner's request to participate in new drilling operations. The circumstances that gave rise to the washout in *Cimarex* are overwhelmingly common, unlike the unique facts in *Ridge Oil*, for example. In the Author's experience, new drilling prospects are more likely than not to contain one or more non-operating leases. Further, the relevant lease language in *Cimarex* is overwhelmingly common. For better or worse, this case likely calls into question the validity of thousands of existing non-operating leases in Texas that were not allowed to participate in development operations.

While the *Cimarex* court was obliged in some degree to follow its prior holding in *Hughes*, both cases can be criticized for fashioning a result from the perceived general purpose of the lease in derogation of its plain language. Specifically, use of the passive-voice in the habendum and rentals clause indicates that the non-operating leases in those cases could be extended by the actions of any party, not just the lessee.²⁰⁰ The court inverted the grammar in both cases. In fact, the lease in *Cimarex* was held to be unambiguous,

196. *Cimarex*, 574 S.W.3d at 92.

197. *Id.* at 96–97.

198. *Id.* at 100.

199. *Id.* at 95–96.

200. *Id.* at 90, 94.

which means that the clear, grammatical meaning of the passive habendum was judged to be an unreasonable reading as a matter of law.²⁰¹

While rules of grammar will give way to context and the parties' expressed intent,²⁰² the *Cimarex* court's arguments for overriding the habendum's clear grammatical meaning are shallow at best. The most obvious criticism of the court's preference for "stated purpose" over plain language is that the lessor has not been deprived of anything it bargained for. If the purpose of the lease is to achieve drilling and production, and drilling and production are actively occurring on the lease, then the purpose of the lease is satisfied.

The court's textual argument for ignoring the plain language is equally unsatisfying. The opinion cites a laundry list of active-voice clauses that require direct action by the lessee as its basis for construing the passive-voice habendum clause actively.²⁰³ But this observation actually compels the opposite conclusion. The unique use of passive voice in the habendum sharply distinguishes it from the prevailing pattern of active-voice clauses, indicating a deliberate variance. After all, "[i]t is not unreasonable to assume that the parties to the lease contract intended, by the use of both words, to give each a distinctly different meaning."²⁰⁴

The *Cimarex* opinion also misrepresents *Cain* in its attempt to distinguish that case from *Cimarex*, stating that "*Cain* did not involve the issue of whether production by one lessee to a lease would affect the lease of a different lessee under a different lease."²⁰⁵ Actually, that is exactly what *Cain* involved. The assignee of the salt rights under the original mineral lease in *Cain* surrendered its lease interest and took a new lease covering only the salt rights it had just surrendered.²⁰⁶ The question was whether salt production under the new lease perpetuated the original lease.²⁰⁷ The answer was yes, it did, because the original lease passively required minerals to be "produced . . . thereon," meaning on the land described in the original lease.²⁰⁸ The *Cain* court construed that language by its plain grammatical meaning.²⁰⁹ Was production occurring on the land described in the original lease? Yes. Were the remaining lessees of the original lease responsible for or entitled to any of that production? Irrelevant. In fact, *Cimarex* presents

201. *Id.* at 87–88 (“[W]e conclude, as a matter of law, that there is only one reasonable interpretation of the *Cimarex* lease, and that the lease is therefore unambiguous . . .”).

202. *See Lyons v. Montgomery*, 701 S.W.2d 641, 643 (Tex. 1985) (“Language used by parties in a contract should be accorded its plain, grammatical meaning unless it definitely appears that the intention of the parties would thereby be defeated.”).

203. *Cimarex*, 574 S.W.3d at 92.

204. *Jones v. Killingsworth*, 403 S.W.2d 325, 328 (Tex. 1965).

205. *Cimarex*, 574 S.W.3d at 93 n.10.

206. *Cain v. Neumann*, 316 S.W.2d 915, 916–18 (Tex. App.—San Antonio 1958, no writ).

207. *See id.* at 916.

208. *See id.* at 918.

209. *See id.* at 919–22.

more compelling facts than *Cain* because Cimarex actually owned a portion of the oil and gas produced from Anadarko's wells, unlike the remaining lessees in *Cain* who did not own any of the salt rights.²¹⁰

The precise language of the habendum in this regard was similarly critical in both *Cain* and *Ridge Oil*. Unlike in *Cain*, the habendum in the *Ridge Oil* lease required oil and gas to be "produced from said land by the lessee,"²¹¹ not merely "produced . . . thereon."²¹² In essence, the *Cimarex* court implied the *Ridge Oil* habendum language—"by the lessee"—into Cimarex's lease, which actually only required "production from said land."²¹³ By that logic, the "by the lessee" language in the *Ridge Oil* lease was superfluous because it was implied by the general purpose of an oil and gas lease; yet the Supreme Court of Texas deemed it dispositive.²¹⁴ The Supreme Court of Texas recently disapproved of exactly this type of judicial interpolation in oil and gas lease assignments.²¹⁵ Further, the unique "by the lessee" language in *Ridge Oil* demonstrates that habendum clauses are not thoughtless boilerplate, but highly negotiated terms that control the duration of the lease. The *Cimarex* court ignores this likelihood that Cimarex's use of the passive voice was a meaningful choice, not an arbitrary drafting convention.

The *Cimarex* court also reasoned that if Cimarex were not required to cause its own production in the secondary term, then "the requirements imposed on Cimarex during both the primary term and the secondary term would be identical, with Cimarex only being required to pay royalties on Anadarko's production during both terms," making "the secondary term completely superfluous."²¹⁶ This statement is inaccurate for at least two reasons. First, the court fails to recognize that a contract term can have use and meaning outside of the specific facts before it. In this case, the habendum would compel Cimarex to drill and produce its own well in any situation where production was not already occurring at the end of the primary term. Just because the habendum can only be satisfied by direct development in some situations does not compel it in all situations.

Second, this statement by the court begs the question—meaning it assumes the very principle it is meant to be proving—that no production occurred under Cimarex's lease. The court assumes without discussion that Cimarex's share of production from Anadarko's wells is not actually

210. *See id.* at 917; *Cimarex*, 574 S.W.3d at 81.

211. *Ridge Oil Co. v. Guinn Invs., Inc.*, 148 S.W.3d 143, 153 (Tex. 2004) (emphasis added).

212. *Cain*, 316 S.W.2d at 918.

213. *Ridge Oil*, 148 S.W.3d at 153; *Cimarex*, 574 S.W.3d at 81.

214. *Ridge Oil*, 148 S.W.3d at 153.

215. *Barrow-Shaver Res. Co. v. Carrizo Oil & Gas, Inc.*, 590 S.W.3d 471, 482–83 (Tex. 2019) (declining to imply reasonableness condition into hard consent-to-assign clause in assignment of oil and gas lease).

216. *Cimarex*, 574 S.W.3d at 94.

Cimarex's production.²¹⁷ The court's statement misses the point of Cimarex's estoppel argument, which is not that payment of royalty itself perpetuates the lease, but that payment of royalty on Cimarex's share of production presupposes that such production is indeed attributable to Cimarex's lease and, therefore, qualifies as constructive production for habendum purposes.

As a refresher, a mineral owner in Texas is free to drill oil and gas wells without the consent or participation of his mineral cotenants, provided that the owner owes his non-participating cotenants their proportionate share of production proceeds, net of drilling and completion costs.²¹⁸ The drilling party may recoup his non-participating cotenants' share of expenses by retaining their share of production proceeds until the well has "paid out," meaning that the revenue from the well has exceeded its drilling and completion costs.²¹⁹

Thus, Cimarex effectively began paying for its share of Anadarko's wells on the day they began producing. Anadarko continuously produced, saved, and sold Cimarex's 1/6 share of hydrocarbons—which was literally Cimarex's property under Texas law—and kept the proceeds.²²⁰ Although it was not allowed to pay development expenses up front, Cimarex still contributed the value of its share of production.²²¹ And although it did not conduct its own operations, Cimarex's hydrocarbons were nonetheless being produced.²²² Moreover, far from "assuming no risk for any losses," Cimarex was involuntarily divested of its share of oil and gas reserves for Anadarko's speculative venture.²²³ In this sense, Cimarex's share of hydrocarbons from the wells may be deemed constructive production from the Cimarex lease.

Although not considered by the court, the Author finds it significant that both of Anadarko's wells had fully paid out before the end of Cimarex's primary term, which arguably distinguishes *Cimarex* from *Hughes*.²²⁴ In

217. *Id.* at 85, 94, 97 (referring to "Anadarko's production" throughout opinion, including share of production on which Cimarex was required to pay royalty).

218. *Byrom v. Pendley*, 717 S.W.2d 602, 605 (Tex. 1986); *Cox v. Davison*, 397 S.W.2d 200, 201 (Tex. 1965) ("The Texas rule is that a cotenant who produces minerals from common property without having secured the consent of his cotenants is accountable to them on the basis of the value of the minerals taken less the necessary and reasonable cost of producing and marketing the same.").

219. HOWARD R. WILLIAMS & CHARLES L. MEYERS, *MANUAL OF OIL AND GAS TERMS* 696 (Matthew Bender ed., Times Mirror Books 7th ed. 1987) (defining "payout" as "the recovery from production of costs of drilling and equipping a well"); *Stable Energy, L.P. v. Newberry*, 999 S.W.2d 538, 543 n.2 (Tex. App.—Austin 1999, pet. denied) ("Payout is reached when the costs of drilling and equipping the well are recovered from production.").

220. *See Lightning Oil Co. v. Anadarko E&P Onshore, LLC*, 520 S.W.3d 39, 48 (Tex. 2017) ("We have consistently recognized both 'the ownership of oil and gas in place' as a property right, and the principle that a mineral lease 'gives to the lessee a determinable fee therein.'") (quoting *Brown v. Humble Oil & Refin. Co.*, 83 S.W.2d 935, 940 (Tex. 1935)); *Cimarex*, 574 S.W.3d at 83.

221. *Cimarex*, 574 S.W.3d at 81–84.

222. *Id.*

223. *Id.* at 97.

224. *See id.* at 81; *Hughes v. Cantwell*, 540 S.W.2d 742, 743 (Tex. App.—El Paso 1976, writ ref'd n.r.e.).

other words, Cimarex had fully paid for its share of drilling and completion costs via Anadarko's recoupment before its primary term ended. As such, Cimarex's interest in the wells at the end of its primary term was the same as if Cimarex had been allowed to participate in the first place. These circumstances make the result in *Cimarex* look particularly inequitable.

Cimarex proposed to further distinguish *Hughes* on the grounds that Cimarex had made repeated unsuccessful offers to Anadarko to enter a joint operating agreement and participate in the wells.²²⁵ This distinction is tempting because it gives Cimarex credit for actions it was willing and able to undertake and avoids the "free rider" problem in *Hughes*, in which the non-operating lease owner was invited but declined to participate.²²⁶ After all, it was Anadarko that elected to carry all of Cimarex's share of the investment risk instead of accepting full payment of Cimarex's share of expenses up front.²²⁷ However, construing an unambiguous contract based on the subsequent behavior of only one of its parties may set troubling precedent for admission of extrinsic evidence.²²⁸

Perhaps the most galling part of the *Cimarex* opinion is that Cimarex still owed royalty on production that did not even perpetuate its lease.²²⁹ The court arrived at this holding by construing the same word—"produced"—as an active verb in the habendum clause and a passive verb in the royalty clause.²³⁰ This inequity is not apparent in the text of the opinion because the court chose not to quote the royalty clause for a comparison, despite this issue being a cornerstone of Cimarex's case. The court remarked that the parties are free to set different standards for payment of royalty and perpetuation of the lease but neglected to actually examine or quote the royalty clause for textual support of its construction.²³¹

To put this inequity in context, non-operating lease owners recently suffered another unfavorable holding on this issue in *Devon Energy Production Co. v. Apache Corp.*²³² The *Devon* court held that the operator of a well was not obligated, as a "payor" under the Texas royalty payment statute, to pay royalty to the lessor of a non-operating lease owner who did not participate in the well.²³³ While no Texas court appears to have directly held that the lessor of a non-participating working interest owner is owed

225. *Cimarex*, 574 S.W.3d at 95.

226. *See id.*; *Hughes*, 540 S.W.2d at 743.

227. *Cimarex*, 574 S.W.3d at 95.

228. *See Barrow-Shaver Res. Co. v. Carrizo Oil & Gas, Inc.*, 590 S.W.3d 471, 483 (Tex. 2019) ("The parol evidence rule bars consideration of evidence that contradicts, varies, or adds to the terms of an unambiguous written agreement.").

229. *Cimarex*, 574 S.W.3d at 94.

230. *See id.* at 90–92.

231. *Id.* at 91.

232. *Devon Energy Prod. Co. v. Apache Corp.*, 550 S.W.3d 259, 263–64 (Tex. App.—Eastland 2018, pet. denied).

233. *Id.* at 264.

royalty on oil and gas produced from a well prior to payout, the courts in *Cimarex* and *Devon* appear to take this principle for granted.²³⁴

This principle makes sense because royalty interests generally do not bear development costs and, therefore, should not be subject to recoupment.²³⁵ However, it disadvantages the non-participating lease owner by requiring him to pay lease royalty out-of-pocket prior to payout before receiving any proceeds of production. As such, *Devon* and *Cimarex* are a veritable Scylla and Charybdis for non-operating lease owners.

C. Lease Drafting to Avoid the Cimarex Result

Drafting tips are cold comfort to the countless parties who already own non-operating leases and have been barred from participation in their operator's wells. Aside from amending their lease or litigating in another appellate district in hope of a more favorable result, non-operating lease owners are largely at the mercy of their operators and lessors in negotiating a reasonable settlement. Nevertheless, industry stakeholders would be wise to amend their non-operating lease form to avoid the problems presented by *Cimarex* in future leasing transactions.

Specifically, *Cimarex* presents the non-operating lease owner with two problems. The first problem is how to perpetuate its lease into the secondary term when it is not allowed to participate in the operator's wells and cannot economically drill its own well. The second problem is how to avoid paying its lessor royalty on production that will not extend its lease into the secondary term. Both of these problems can be solved in the lease drafting process. Rather than directly editing habendum and royalty clauses, of which there are near infinite varieties, the Author suggests using a standalone provision that can be added to a wide range of lease forms.

As discussed above, equity urges that if a non-participating lease owner owes his lessor royalty on production from a cotenant's well prior to payout, as Texas law appears to require,²³⁶ then production from that well after the primary term should be deemed to satisfy the habendum to extend the lease into the secondary term. To that end, language can be added to a lease form

234. See *Cimarex*, 574 S.W.3d at 85; *Devon*, 550 S.W.3d at 260. This question was not at issue in either case. The plaintiff in *Cimarex* had already paid royalty out of pocket prior to payout, making it difficult to later argue that such royalty was not owed. *Cimarex*, 574 S.W.3d at 84–85. The parties in *Devon* appear to agree that royalty was owed prior to payout but disagree about who owed it. *Devon*, 550 S.W.3d at 260.

235. Although not discussed in its opinion, the *Devon* court apparently allows the operator, as part of its right to recoup development costs from the non-participating lease owner, to also retain the royalty that would otherwise be owed to the lessor of the non-participating lease owner. *Devon*, 550 S.W.3d at 262–63. This result seems to cut against the principle that royalty interests should not be subject to recoupment for development costs. See *id.* at 262.

236. *Id.* at 261–62.

to create a reciprocal link between the royalty and habendum clauses, such as the following:

Oil, gas, or other minerals produced after the primary term on which royalty is payable under Section [3] hereof shall be deemed production under Section [2] hereof for the purpose of extending this lease into the secondary term.

This succinct clause relies on Texas law—or at least the widespread assumption—that the non-participating lease owner owes royalty to his lessor prior to payout. However, some parties may prefer to be more explicit about the contractual mechanics:

Oil, gas, or other minerals produced after the primary term from the lands covered by this lease shall be deemed production under Section [2] hereof for the purpose of extending this lease into the secondary term, and royalty shall be payable on such production under Section [3] hereof, *regardless of whether* lessee conducted, participated in, or consented to the drilling, reworking, completion, or other operations that resulted in such production.

Of course, parties to a lease may wish to reverse the mechanics such that production from a cotenant's well will not extend a non-participating lease into the secondary term, but neither will royalty be payable on such production. For that effect, the clause immediately above can be inverted by changing one small phrase:

Oil, gas, or other minerals produced after the primary term from the lands covered by this lease shall be deemed production under Section [2] hereof for the purpose of extending this lease into the secondary term, and royalty shall be payable on such production under Section [3] hereof, *if and only if* lessee conducted, participated in, or consented to the drilling, reworking, completion, or other operations that resulted in such production.

Note that the clause immediately above may not be appropriate to use in a lease of land with existing production, like a replacement lease on a mature field, because it would require participation in operations that occurred prior to the execution of the lease.²³⁷ Likewise, all of the sample clauses above should be carefully reviewed alongside the other lease terms, and in light of the specific circumstances of the lease transaction, to ensure the intended effects and avoid unintended ones.

237. See generally *id.* (discussing that production from a cotenant will extend the secondary term).

VI. *YOWELL V. GRANITE OPERATING: A RAP ON THE WRIST*

In *Yowell v. Granite Operating Co.*, the Supreme Court of Texas broke new ground on the enforceability of anti-washout clauses and application of the Texas “cy pres” statute requiring courts to reform conveyances that violate the rule against perpetuities (RAP).²³⁸ The central questions in *Yowell* were: (1) whether the anti-washout clause in an overriding royalty reservation violated RAP; and (2) if so, whether the reservation was eligible for reformation under Texas Property Code § 5.043.²³⁹

A. *The Case*

In *Yowell*, an overriding royalty was reserved from an assignment of a 1986 oil and gas lease, subject to the following typical anti-washout clause:

Should the Subject Leases . . . terminate and in the event Assignee . . . obtains an extension, renewal or new lease or leases covering or affecting all or part of the mineral interest covered and affected by said lease or leases, then the overriding royalty interest reserved herein shall attach to said extension, renewal or new lease or leases.²⁴⁰

The lease and overriding royalty came to be respectively owned by Granite Operating Company and the Yowells.²⁴¹ The lease was held by production until 2007 when a dispute arose about the termination of Granite’s lease for lack of production.²⁴² Granite acquired top leases on the property and released the prior lease.²⁴³ Granite stopped paying the Yowells, who sued for a judicial declaration that their override applied to Granite’s new leases by operation of the anti-washout clause.²⁴⁴

Granite first argued in defense that the anti-washout clause is merely a contract right, not a real property interest, which was unenforceable on appeal because the Yowells did not plead a breach of contract action.²⁴⁵ The Court found no support for this argument, holding that:

[W]hether the ORRI is extended and in what form—as a share of production under a renewed lease or under a new lease involving the same land and parties—will be contingent on a leasing decision by the lessor, a non-party

238. See *Yowell v. Granite Operating Co.*, 620 S.W.3d 335 (Tex. 2020).

239. *Id.* at 340.

240. *Id.* at 345–46.

241. *Id.* at 342.

242. *Id.* at 341–42.

243. *Id.* at 341–43.

244. *Id.* at 342.

245. *Id.* at 343–44.

to the ORRI. But that contingency does not deprive an ORRI that continues under a new or renewed lease of its character as a property interest.²⁴⁶

The Court recognized that the anti-washout clause also gave rise to a contract right, similar to an oil and gas lease, but that issue was not before the Court.²⁴⁷ Granite then argued that the anti-washout clause violated RAP, which the Court articulated as follows: “[N]o [property] interest is valid unless it must vest, if at all, within twenty-one years after the death of some life or lives in being at the time of the conveyance.”²⁴⁸ The Yowells argued that their reserved overriding royalty was a single interest in both the existing and future leases vested as a whole at the time of its creation.²⁴⁹ The Court rejected this argument based on its holding in *ConocoPhillips v. Koopmann*, stating that the clause did not create an “immediate, fixed right of present or future enjoyment as to new leases because those leases were not yet in existence.”²⁵⁰ Notably, the Court agreed with a Tenth Circuit case holding that an anti-washout clause is vested upon creation to the extent that it applies to extensions or renewals of a lease, but declined to extend that holding to new leases.²⁵¹

Because the anti-washout clause created an unvested interest, the Court held that it was executory in nature and, therefore, subject to RAP.²⁵² The Court described an executory interest as “a future interest, held by a third person, that either cuts off another’s interest or begins after the natural termination of a preceding estate” and is therefore “subject to invalidation by [RAP] when they were limited upon conditions precedent not certain [to] occur, if ever, and followed a prior estate not certain to end.”²⁵³

Specifically, the interest was contingent on three remote conditions precedent: (1) termination of the prior lease; (2) execution of a new lease covering the same mineral interest as the prior lease; and (3) acquisition of the new lease by a successor lessee of the prior lease.²⁵⁴ None of these contingencies were certain to ever occur, much less within the maximum perpetuities period, so the anti-washout clause violated RAP.²⁵⁵ The Court did note that the first condition may fall under the limited exception to RAP established by *Koopmann* because an oil and gas lease is practically certain to terminate at some point.²⁵⁶ However, the uncertainty of the two additional

246. *Id.* at 344–45.

247. *Id.* at 343–44.

248. *Id.* at 343 (quoting *Peveto v. Starkey*, 645 S.W.2d 770, 772 (Tex. 1982)).

249. *Id.* at 343–46.

250. *Id.* at 345–46 (discussing *ConocoPhillips Co. v. Koopmann*, 547 S.W.3d 858 (Tex. 2018)).

251. *Id.* at 347 (discussing *Indep. Gas & Oil Producers, Inc. v. Union Oil Co. of Cal.*, 669 F.2d 624 (10th Cir. 1982)).

252. *Id.*

253. *Id.* at 345 (quoting *Koopmann*, 547 S.W.3d at 871).

254. *Id.* at 346.

255. *Id.* at 347.

256. *Id.* at 349; see *Koopmann*, 547 S.W.3d at 871.

contingencies prevented the Court from extending *Koopmann* because, unlike the interest in *Koopmann*, the Yowells' interest was not "certain to vest in an ascertainable grantee" at some future date.²⁵⁷

The Yowells then argued that their interest was not void for violation of RAP but was eligible for reformation under the Texas "cy pres" statute in Texas Property Code § 5.043:

(a) Within the limits of the rule against perpetuities, a court shall reform or construe an interest in real or personal property that violates the rule to effect the ascertainable general intent of the creator of the interest. A court shall liberally construe and apply this provision to validate an interest to the fullest extent consistent with the creator's intent.

(b) The court may reform or construe an interest under Subsection (a) of this section according to the doctrine of cy pres by giving effect to the general intent and specific directives of the creator within the limits of the rule against perpetuities.

(c) If an instrument that violates the rule against perpetuities may be reformed or construed under this section, a court shall enforce the provisions of the instrument that do not violate the rule and shall reform or construe under this section a provision that violates or might violate the rule.

(d) This section applies to legal and equitable interests, including noncharitable gifts and trusts, conveyed by an *inter vivos* instrument or a will that takes effect on or after September 1, 1969²⁵⁸

Granite argued that the Yowells' interest is not eligible for reformation because subsection (d) limits its application to gifts and trusts.²⁵⁹ The Court disagreed, construing "including" as a term of enlargement, not limitation or exclusivity.²⁶⁰ Granite then argued that the lease assignment creating the Yowell's interest was not an "*inter vivos* instrument," again as required by subsection (d), because the assignor was a corporation, not a natural person.²⁶¹ The Court held that corporations are capable of executing *inter vivos* instruments, citing the Texas statutory treatment of corporations as "persons" for the purpose of creating trusts.²⁶² The Court also noted the statutory directive that courts "liberally construe and apply [it] to validate an interest to the fullest extent consistent with the creator's intent," which would not be possible under Granite's theory.²⁶³ The Court's holding on this discrete issue appears to eliminate a longstanding assumption that commercial transactions are ineligible for reformation under the "cy pres" statute.²⁶⁴

257. *Id.* at 349 (quoting *Koopmann*, 547 S.W.3d at 873).

258. *Id.* at 350 (quoting TEX. PROP. CODE § 5.043 Ann.).

259. *Id.* at 350.

260. *Id.*

261. *Id.* at 351 (emphasis added) (quoting PROP. CODE § 5.043(d)).

262. *Id.* at 351-52 (citing PROP. CODE §§ 111.004, 112.001; TEX. GOV'T CODE § 311.005(2) Ann.).

263. *Id.* at 351 (quoting PROP. CODE § 5.043(a)).

264. *See Yowell v. Granite Operating Co.*, 557 S.W.3d 794, 804 (Tex. App.—Amarillo 2018), *aff'd*

In its final argument, Granite argued that the Yowells are nevertheless barred from seeking a reformation of its interest by the four-year statute of limitations on deed reformation actions.²⁶⁵ The Court disagreed, holding that the “cy pres” reformation statute “is an instruction to courts on how to remedy a violation of [RAP], not a cause of action subject to a statute of limitations” like an action for deed reformation or breach of contract.²⁶⁶ The Court ultimately held that the Yowells’ executory interest in future leases violates RAP and remanded the case to reform the interest, if possible, in compliance with Texas Property Code § 5.043.²⁶⁷ Although the Yowells managed to avoid the death penalty for their overriding royalty, they did receive a slap on the wrist in the form of additional litigation to implement cy pres.

B. Drafting RAP-Resistant Anti-Washout Clauses

The irony of *Yowell* is palpable: After decades of Texas courts admonishing override owners for failing to cover new leases in their anti-washout clauses, it turns out that amending the clause to cover new leases actually violates RAP. Anti-washout clauses are practically boilerplate in instruments creating overriding royalties and other non-operating interests in oil and gas leases, but they need serious drafting attention to avoid the negative effects of *Yowell*.

The obvious advice for practitioners is to add language to anti-washout clauses that forces termination of the executory interest before the end of the perpetuities period, also known as a perpetuities savings clause.²⁶⁸

Unfortunately, cases addressing the effectiveness or validity of perpetuity savings clauses are difficult to find. One commentator recently stated that no reported Texas case has ever addressed the topic, which may indicate that the clauses work as intended and thereby prevent litigation.²⁶⁹ Still, commentators in a wide range of practice areas appear to uniformly endorse the clause as a failsafe against RAP, with some suggesting that failure to include one may breach the lawyer’s duty of care.²⁷⁰

in part, rev'd in part, 620 S.W.3d 335 (Tex. 2020) (“[T]he Yowell group has not cited, and we have not found, any case in which Section 5.043 was used to reform a commercial instrument such as this one.”).

265. *Id.* at *29, *31.

266. *Id.* at *30.

267. *Id.* at *31.

268. Note that anti-washout clauses are typically limited to new or replacement leases taken within a time period after termination of the existing lease, often one year. *See generally* SM Energy Co. v. Sutton, 376 S.W.3d 787 (Tex. App.—San Antonio 2012, pet. denied); EOG Res., Inc. v. Hanson Prod. Co., 94 S.W.3d 697 (Tex. App.—San Antonio 2002, no pet.). This limitation is unrelated to the perpetuities problem and will not satisfy RAP. *See SM Energy Co.*, 376 S.W.3d 787; *EOG Res., Inc.*, 94 S.W.3d at 699–700.

269. Zachary Horne, *The “Dead Hand” in Oil and Gas Transactions: How the Rule Against Perpetuities is Rearing its Ugly Head in Texas Oil and Gas Law*, 60 S. TEX. L. REV. 697, 722–23 (2020).

270. S. Alan Medlin & F. Ladson Boyle, *What Every South Carolina Lawyer Should Know About the (Ugh!) Rule Against Perpetuities*, 2 S.C. LAW. 27, 27 (1991). *But see* Peter H. Schuck, *Legal Complexity:*

The simplest form of perpetuities protection is to limit the interest created by the anti-washout clause to an absolute term of no more than twenty-one years from the creation of the interest.²⁷¹ This hard termination date complies with RAP on its face and altogether avoids any question about lives-in-being. However, this amendment might not have helped the petitioners in *Yowell* because the twenty-one-year term would have ended before the new lease was executed. As such, practitioners may wish to use a more tailored, far-reaching perpetuities savings clause, such as the following:

Any right or interest created by this instrument which would violate any applicable Rule against Perpetuities or the suspension of the power of alienation, or any similar rule of law, shall terminate no later than twenty-one years after the death of the last survivor of [specific individuals serving as lives-in-being].²⁷²

This example names specific lives-in-being and thereby creates an ascertainable and roughly predictable termination date for the anti-washout clause. This feature allows the parties to a transaction—or their successors-in-interest, more likely—to monitor the termination of the interest by tracking the demise of specified natural persons. Identifying those individuals may present challenges in negotiation, but the Author suggests starting with the following formulation: “. . . all natural persons who are a party or signatory to this Agreement.” By covering signatories as well as parties, this language accounts for all persons joining the instrument regardless of capacity, such as trustee, administrator, attorney-in-fact, or corporate representative.

This formulation may not be ideal for transactions with a small number of parties, however. The beneficiary of the anti-washout clause should want to name as many lives-in-being as possible to increase the odds that one of them will live a long and healthy life. To that end, parties to a commercial oil and gas assignment with corporate entity parties may wish to expand the class of lives-in-being by adding this language: “. . . or are a current officer, director, manager, partner, owner, or shareholder of a party to this Agreement.” Likewise, for a conveyance between individuals, especially elderly parties, the parties may wish to vitalize the lives-in-being class by adding this language: “. . . or are a living descendant, spouse, ex-spouse, or sibling of a party or signatory to this Agreement.”

Some Causes, Consequences, and Cures, 42 DUKE L.J. 1, 5 n.18 (1992) (citing *Lucas v. Hamm*, 364 P.2d 685 (Cal. 1961)).

271. See John C. Murray, *Options and Related Rights and the Rule Against Perpetuities*, 42 N.Y. REAL PROP. L.J. 28, 32 exhibit B (2014).

272. See J. Hovey Kemp & J. Forbes Newman, ROCKY MT. MIN. L. FOUND., *Hidden Rule Against Perpetuities Problems in Oil & Gas Transactions* § 16.06 n.137 (1986); see 2 TEX. ESTATE PLANNING §§ 170.06, 120.08 (2020).

Here is another sample of commonly-used perpetuities savings language:

No right or interest created by this instrument shall continue longer than the maximum term allowed by applicable state law. If such a right or interest is capable of extending beyond the term permitted by law, then it shall terminate at the expiration of the latest time permitted by law.²⁷³

This example attempts to create the longest possible term by incorporating applicable laws by reference and not specifying the lives-in-being. This approach might theoretically give the anti-washout clause a longer survival period, but the lack of specific lives-in-being is likely to result in disputes about who is included in that class and, consequently, whether or not the anti-washout clause has terminated. Moreover, some commentators maintain that this style of perpetuities savings clause is too broad to be effective, though there appears to be disagreement on this point.²⁷⁴

C. Defending Existing Anti-Washout Clauses

Drafting tips are all well and good, but countless anti-washout clauses have already been deployed in oil and gas instruments and none are likely to contain a perpetuities savings clause. *Yowell* may provide a narrow path for existing anti-washout clauses to escape avoidance under RAP, but the time and expense of litigating a cy pres reformation action remains a major obstacle. And, unfortunately, precious little precedent exists to guide litigants in this effort.

Cases addressing whether an interest qualifies for statutory cy pres reformation are easy to find,²⁷⁵ as are cy pres reformation cases not involving RAP.²⁷⁶ But modern reported cases discussing a court's actual reformation of an instrument for a RAP violation are vanishingly scarce for a variety of reasons. First, the mandatory reformation required by cy pres encourages

273. See 2 TEX. ESTATE PLANNING § 120.08 (2020).

274. See 10 POWELL ON REAL PROPERTY § 72.04(5) (2020); David M. Becker, *If You Think You No Longer Need to Know Anything About the Rule Against Perpetuities, Then Read This!*, 74 WASH. U. L. Q. 713, 733–34 (1996).

275. See *Foshee v. Republic Nat'l Bank of Dall.*, 617 S.W.2d 675 (Tex. 1981); *Caruso v. Young*, 582 S.W.3d 634 (Tex. App.—Texarkana 2019, no pet.); *Marsh v. Frost Nat'l Bank*, 129 S.W.3d 174 (Tex. App.—Corpus Christi 2004, pet. denied); *Meduna v. Holder*, No. 03-02-00781-CV, 2003 Tex. App. LEXIS 10568, 2003 WL 22964270 (Tex. App.—Austin Dec. 18, 2003, pet. denied); *Johnson v. McLaughlin*, 840 S.W.2d 668 (Tex. App.—Austin 1992, no pet.); *Ball v. Knox*, 768 S.W.2d 829 (Tex. App.—Houston [14th Dist.] 1989, no writ); *Barrows v. Ezer*, 668 S.W.2d 854 (Tex. App.—Houston [14th Dist.] 1984, writ ref'd n.r.e.); *Maupin v. Dunn*, 678 S.W.2d 180 (Tex. App.—Waco 1984, no writ).

276. See RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS § 1.5 (Am. L. Inst 1983); Abraham B. Dyk, *A Better Way to Cy Pres: A Proposal to Reform Class Action Cy Pres Distribution*, 21 N.Y.U. J. LEGIS. & PUB. POL'Y 635 (2018).

compromise and settlement, making appeals less likely.²⁷⁷ Second, use of cy pres has historically been restricted to the narrow field of wills, trusts, and other instruments of donative or charitable intent.²⁷⁸ Third, many states have adopted “wait and see” legislation, which typically resolves a RAP violation before cy pres reformation becomes necessary.²⁷⁹ In “wait and see” jurisdictions, an interest in violation of RAP is not held void until the interest has actually failed to vest within the period prescribed by RAP.²⁸⁰

Texas is among the few states that mandates immediate cy pres reformation for a RAP violation, i.e., it does not first apply a “wait and see” approach.²⁸¹ The Texas Legislature also expanded cy pres reformation statute in 1991 to apply to non-charitable instruments.²⁸² Still, it appears that no reported Texas case has ever addressed the mechanics or principles of an actual cy pres reformation.²⁸³ The most informative Texas case on this topic appears to be *Meduna v. Holder*, in which the Austin Court of Appeals held that: (1) the trial court erred in voiding an entire deed when only one of several interests granted thereunder violated RAP; and (2) the Texas cy pres reformation statute was applicable to the offending interest.²⁸⁴ “[T]he trial court should have struck those conveyances that violate the rule, enforced those that do not, and to the extent possible, reformed the deed to effectuate the grantors’ intent.”²⁸⁵ The court remanded the case, noting that “[t]he trial court . . . is in a better position to develop the evidence, determine the intent of the grantors, and reform the deed to reflect that intent.”²⁸⁶ As such, *Meduna* may be largely immaterial in a court’s reformation of an overriding royalty interest in a case like *Yowell*, other than to show that a RAP violation does not void the entire reservation in the lease assignment that created the interest.

Texas cases involving deed reformation due to mutual mistake of the parties are plentiful, but also may not be helpful in a cy pres reformation context. Mutual mistake reformations are generally limited to accidental misstatements, omissions, or inclusion of terms that are easily corrected once

277. Ira Mark Bloom, *Perpetuities Refinement: There is an Alternative*, 62 WASH. L. REV. 23, 72–73 (1987).

278. See RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS, § 1.5; *Foshee*, 617 S.W.2d at 675.

279. See 10 RICHARD R. POWELL, POWELL ON REAL PROPERTY § 75A.03 (2020).

280. *Id.*

281. These states appear to include California, Missouri, Oklahoma, Texas, and Idaho. See RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS, § 1.5.

282. Act of July 16, 1991, 72nd Leg., R.S., ch. 895, Tex. Gen. Laws 3062.

283. As of 1987, “[f]rom the four states which legislatively prescribe immediate cy pres reformation, only two California cases have been reported.” Bloom, *supra* note 277, at 72–73; see *Estate of Ghiglia*, 42 Cal. App. 3d 433 (Ct. App. 1974) (reforming class gift to testator’s grandchildren to take effect when youngest grandchild reaches twenty-one rather than thirty-five years); *Estate of McNeill*, 230 Cal. App. 2d 449 (Ct. App. 1964) (accelerating remainder to accomplish intent of testator).

284. *Meduna v. Holder*, No. 03-02-00781-CV, 2003 Tex. App. LEXIS 10568, 2003 WL 22964270, at *1 (Tex. App.—Austin Dec. 18, 2003, pet. denied).

285. *Id.* at *27.

286. *Id.*

mutuality is established, such as a scrivener's error or an incorrect property description.²⁸⁷ A cy pres reformation, on the other hand, requires a substantive rewriting of the offending interest to approximate the grantor's intent.²⁸⁸ Of course, determining the "grantor's intent" plays a large role in construction of an ambiguous conveyance through consideration of extrinsic evidence.²⁸⁹ But, again, the grantor's intent is largely settled in an oil and gas RAP violation case: the grantor intended to create a perpetual estate. The relevant question is how to amend the conveyance text to achieve the longest estate duration possible without violating RAP. As such, legal principles for construing ambiguous instruments may also prove unhelpful.

Given this dearth of precedent and useful analogs, Texas courts and practitioners will be largely unconstrained in theorizing the best and proper principles of cy pres reformation. Granite might well argue on remand in *Yowell* that "new lease or leases" should simply be stricken from the overriding royalty reservation because that is the only part that violates RAP. The Yowells may respond that doing so would defeat the purpose of the cy pres reformation statute because it would have the same effect as not applying cy pres at all, i.e., it would altogether nullify the Yowells' executory interest. Time will tell what arguments and evidence Texas courts will deem persuasive and relevant.

Now that the Supreme Court of Texas has expanded the application of Texas Property Code § 5.043 to incorporate conveyances and commercial instruments, cy pres reformation cases may become far more common in Texas appellate courts than they have been historically. On the other hand, they may remain infrequent since mandatory reformation means that a RAP violation is not absolutely fatal to an offending interest, making disputes more likely to be settled. Again, time will tell.

D. Lingering Limitations Questions

As is common with groundbreaking cases, more questions are raised than answered in *Yowell*, especially regarding the lack of limitations. Since cy pres reformation is a mandate to the courts that is not subject to the four-year statute of limitations for deed reformation, is there any temporal limit on its application? Statutes typically operate prospectively only, i.e., they are not controlling on prior events and instruments, unless the legislature clearly states otherwise.²⁹⁰ However, the Yowells' interest was created in 1986, which was prior to the 1991 amendment to the Texas Property Code § 5.043

287. See *Simpson v. Curtis*, 351 S.W.3d 374 (Tex. App.—Tyler 2010); *KCCC Props. v. Quality Vending, Inc.*, 312 S.W.3d 231 (Tex. App.—Amarillo 2010, pet. denied).

288. See generally *Meduna*, No. 03-02-00781-CV, 2003 Tex. App. LEXIS 10568.

289. See *Nat'l Union Fire Ins. Co. v. CBI Indus., Inc.*, 907 S.W.2d 517 (Tex. 1995); *Coker v. Coker*, 650 S.W.2d 391 (Tex. 1983).

290. See *Quick v. City of Austin*, 7 S.W.3d 109, 131 (Tex. 1998).

allowing reformation of non-charitable and commercial instruments.²⁹¹ Therefore, either the 1991 amendment applies retroactively to prior instruments or the statute never actually excluded non-charitable and commercial instruments to begin with. In either case, there appears to be no backward-looking limitations at all on the application of the Texas cy pres reformation statute, which presents practical problems.

For example, is cy pres reform available for top leases and top deeds that lack a present conveyance of the possibility of reverter, like those in *Peveto v. Starkey* and *Hamman v. Bright & Co.*?²⁹² The offending interests in those cases were held void, but, in light of *Yowell*, the proper holding may have been to remand for reformation. What becomes of the intervening interest owners, like the bottom lessees in *Peveto* and *Hamman*, whose rights are based on the Court's prior holdings that RAP-violating interests are void ab initio? Does their longstanding reliance on that precedent make cy pres reformation impossible or impracticable? The holding in *Yowell* likewise arrived too late for the parties in *Koopman*.²⁹³ Had the plaintiff in that case pled for cy pres reformation, would the Court have simply held that the *Koopman* interest violated RAP and remanded the case for reformation instead of inventing a novel exception to RAP?

Like *Cimarex*, *Yowell* is truly a ground-shifting event in the title landscape for oil and gas industry stakeholders in Texas. Unfortunately, few guideposts exist to help practitioners avoid hidden pitfalls, which may be deep and numerous.

VII. CONCLUSION

Given the new landscape of washout jurisprudence in Texas resulting from the cases discussed above, industry stakeholders and oil and gas legal practitioners should carefully review the terms of their existing non-operating interests and their preferred instrument forms, and amend them where necessary to protect against the previously unknown dangers revealed by the new cases discussed herein.

291. Petition for Review, 2, *Yowell v. Granite Operating Co.*, No. 18-0841 (Tex. Sept. 6, 2018).

292. See *Peveto v. Starkey*, 645 S.W.2d 770 (Tex. 1982); *Hamman v. Bright & Co.*, 924 S.W.2d 168 (Tex. App.—Amarillo 1996, writ granted w.r.m.).

293. See *ConocoPhillips Co. v. Koopmann*, 547 S.W.3d 858, 869–70 (Tex. 2018).