

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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Road Washout



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Lease Washout

- A “washout” occurs when an oil and gas lease operator terminates and reacquires a lease in order to:
 - eliminate lease burdens; or
 - annex non-operating working interests.

Lease Washout

- Elements of washout transaction:
 1. Operating lessee releases lease or allows it to terminate for lack of production.
 2. Lease burdens and/or non-op interests co-terminate with lease.
 3. Operating lessee acquires new lease on same mineral interest free and clear of burdens and non-op interests.

Why Washout?

- Operator has financial incentive to increase NRI and/or WI by washing out lease burdens and non-ops.
- May be cheaper and easier to acquire new lease than buy outstanding interests.
- Texas law generally permits washout transactions, even when done intentionally.
- See paper for review of other jurisdictions.

Types of Washouts

- Overriding royalty interest (ORRI) washout
 - Any type of lease burden that does not confer the right to drill and produce
 - Net profits interest, security interest, back-in option
- Working interest washout
 - Cotenants in same lease
 - Cotenants in separate leases

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