

# 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

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- 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

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- 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?

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- 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

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- 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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