

SUBJECT: Establishing a cause of action for bad faith washouts of oil and gas leases

COMMITTEE: Judiciary and Civil Jurisprudence — committee substitute recommended

VOTE: 8 ayes — Leach, Davis, Julie Johnson, Krause, Middleton, Moody,  
Schofield, Smith

0 nays

1 absent — Dutton

WITNESSES: For — Reagan Marble; (*Registered, but did not testify*: Julie Moore,  
Occidental Petroleum; Jason Modglin, Texas Alliance of Energy  
Producers)

Against — None

DIGEST: CSHB 4218 would authorize a person to bring a cause of action for a bad  
faith washout of the person's overriding royalty interest in an oil and gas  
lease.

The bill would define "washout" to mean the elimination or reduction of  
an overriding royalty interest in an oil and gas lease by the forfeiture or  
surrender of the lease and the subsequent reacquisition of a lease free of  
the overriding royalty interest. The bill would define "bad faith" to mean  
the conscious taking of action for the purpose of washing out all or part of  
an overriding royalty interest.

A person would be entitled to a remedy if able to prove by a  
preponderance of the evidence that:

- the person owned or had a legal right to the overriding royalty  
interest;
- the defendant had control over the oil and gas lease burdened by  
that interest;
- the defendant caused a washout of the person's interest; and

- the defendant acted in bad faith by knowingly or intentionally causing the washout.

An owner of an overriding royalty interest in an oil and gas lease would be authorized to bring an action in a district court of a county in which any part of the property subject to the lease was located. An owner who prevails in an action could recover:

- actual damages;
- enforcement of a constructive trust on the oil and gas lease or mineral estate acquired to accomplish the washout of the interest; and
- court costs and attorney's fees.

The provided remedies would be cumulative of other remedies provided by common law or statute. A person would be required to bring an action within two years of the date the person obtained actual knowledge that the washout occurred.

The bill would take effect September 1, 2021, and would apply only to a washout that occurred on or after that date.

**SUPPORTERS  
SAY:**

CSHB 4218 would ensure that owners of an overriding royalty interest received their deserved payments for crucial services by establishing a cause of action against bad faith washouts. Overriding royalty interests are typically granted as a form of payment for brokers, landmen, geologists and other persons who are essential to bringing about the development of an oil and gas lease. Rather than accept a one-time payment, these individuals instead receive a portion of the lease's total production revenue. This is a payment that is earned by persons essential to the lease's future production and should be honored. It is appropriate to establish a cause of action to address bad faith attempts to wash these individuals out.

The bill sets an appropriate legal standard for the established cause of action. Together, the bill's definitions of "bad faith" and "washout" serve to reinforce each other and make the bill's meaning clear. Read together,

the clear factor in determining a bad faith washout is the relatively quick resumption of another lease that is free of the overriding royalty interest. Affected individuals who have their interest removed under a new lease that is otherwise similar to the canceled lease would have a clear path to a successful cause of action under the bill.

Concerns about the bill's effects on the development of marginally profitable oil and gas leases are unfounded and do not account for the methods currently used in such situations. Owners of overriding royalty interests are typically willing to work out an altered payment structure rather than see a lease go undeveloped. Additionally, they sometimes choose to sell their interest back to the lease holder in exchange for a one-time payment. It benefits interest holders to be flexible and alter the terms of an existing royalty interest rather than receive no payment from an undeveloped lease. These royalty interests represent previously agreed payment for vital services, and the existing methods for altering this payment method render any attempt to washout the interest owner unnecessary.

CRITICS  
SAY:

The requirement to prove bad faith in an action brought under the provisions of the bill may be too high of a standard. The necessity of showing in court by a preponderance of the evidence that the act of washing out an overriding royalty interest owner was done consciously for the purpose of removing that royalty could be a difficult standard to meet. The cause of action should instead rely only on the bill's definition of "washout" which would make the rapid resumption of a lease free of the washed out royalty interest the most important factor in an action brought under the bill.

OTHER  
CRITICS  
SAY:

The bill could create a chilling effect on the development of marginally profitable oil and gas leases. There are instances where the overriding royalty interest could mean the difference between profitability and unprofitability for an oil and gas lease. Creating a new lease free of the overriding royalty interest would negatively impact the owner of that interest, but allowing the lease to be developed rather than sit idle would create the most benefit for the state.

