

Lease Transfer Troubles: ORRIs, Washouts, Transfer Restrictions, and “Wellbore” Assignments

Presented by:
Andy Graham



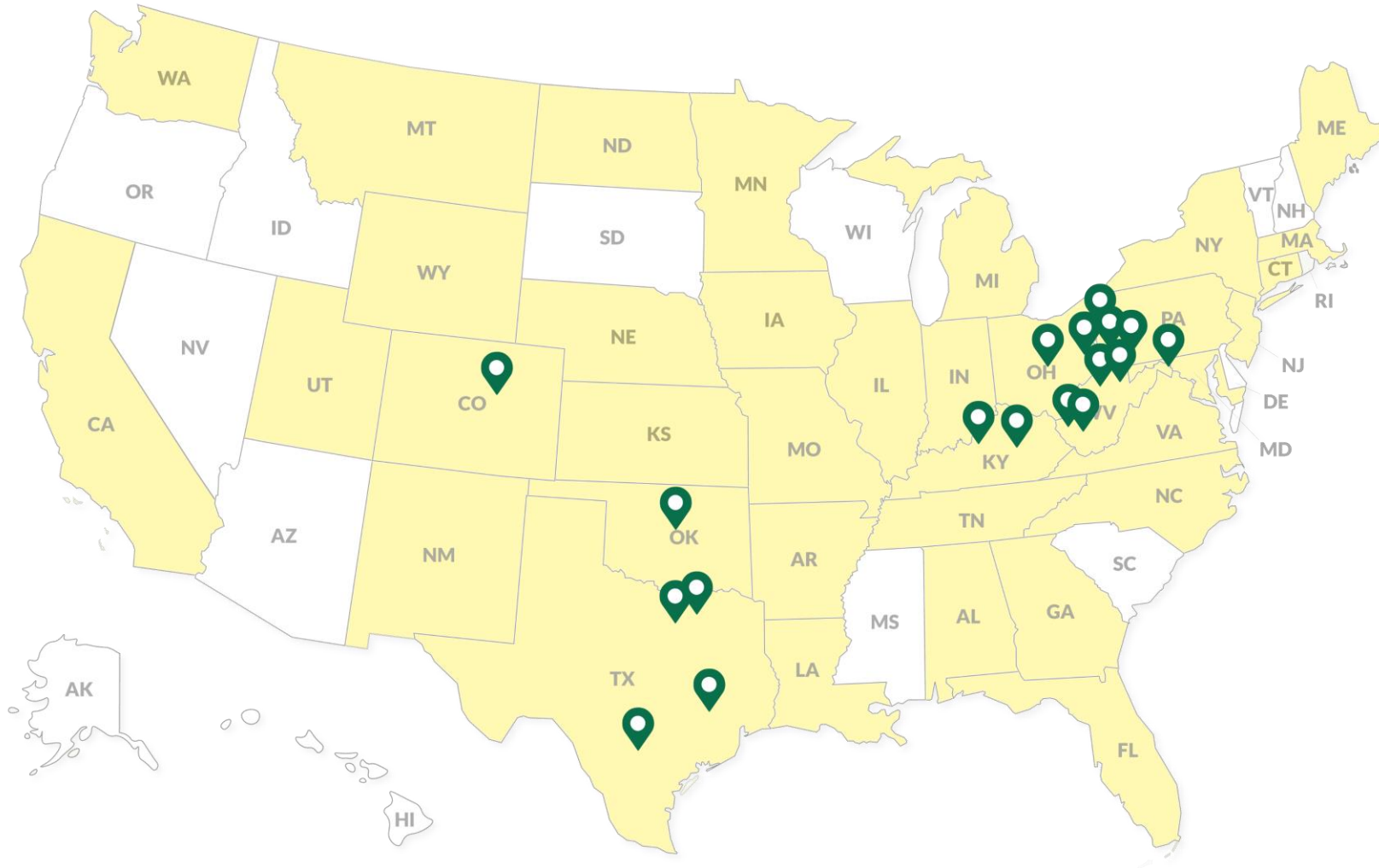
April 30, 2025

Presenter



Andy Graham

andy.graham@step toe-johnson.com
(304) 598-8161



Office Locations

- Bridgeport, WV
- Charleston, WV
- Collin County, TX
- Columbus, OH
- Dallas, TX
- Denver, CO
- Huntington, WV
- Lexington, KY
- Louisville, KY
- Martinsburg, WV
- Meadville, PA
- Morgantown, WV
- Oklahoma City, OK
- Pittsburgh, PA
- San Antonio, TX
- Southpointe, PA
- The Woodlands, TX
- Wheeling, WV

 **Attorney Licensure**

Agenda

- Lessee's right to transfer OGL
- Effect of transfer on the lessor
- Rights and duties of the lessee and assignee
- "Wellbore" assignments

The background is a dark blue field filled with a complex network of thin, light blue lines connecting various points. These points are represented by small, glowing blue dots of varying sizes, creating a sense of depth and connectivity, similar to a molecular structure or a digital network.

Lessee's right to assign

Lessee's right to transfer

- General rule: interests created by OGLs are freely assignable unless reasonable limits are imposed by express terms when interests are created
 - Example: *Shields v. Moffitt*, 683 P.2d 530 (Okla. 1984)
 - OGL: “This lease may be assigned only with the written consent of the lessors.”
 - Court held that provision was void as an unreasonable restraint on alienation
 - Example: *Barrow-Shaver Res. Co. v. Carrizo Oil & Gas, Inc.*, 590 S.W.3d 471 (Tex. 2019)
 - F/O: “The rights provided to [Farmee] under this Letter Agreement may not be assigned, subleased or otherwise transferred in whole or in part, without the express written consent of [Farmor].”
 - Court declined to imply reasonableness requirement into express consent-to-assign provision
 - Court emphasized the sophistication of the parties in negotiating the provision
- Some courts still recognize the Rule in Dumpor's Case
 - *Dumpor v. Syms*, 4 Coke 119 (1578); rule abolished in England in 1859
 - Example: *Rockwell Mining, LLC v. Pocahontas Land LLC*, 726 F.Supp.3d 567 (S.D.W. Va. 2024)

Lessee's right to transfer

- OGL forms often contain provisions that expressly permit assignment
 - Example: “The rights of each party hereunder may be assigned in whole or in part,…”
 - Example: “The rights of Lessor and Lessee hereunder may be transferred, in whole or in part and as to any substances or zone.”
 - Example: “Lessee shall have the right to assign this lease or any interest therein and the assignee of Lessee shall have corresponding rights, privileges, and obligations with respect to said royalties and the other obligations related to the acreage or interest assigned to it.”
- Such provisions directly address both the question of transferability and divisibility of the lease
- Assignment of OGL must meet the other requirements for a valid conveyance, such as (1) be in writing, (2) have words of grant, (3) contain adequate description, (4) identify competent parties, and (5) be properly executed

The background is a dark blue field filled with a complex network of thin, light blue lines connecting various points. These points are represented by small, glowing blue dots of varying sizes, creating a sense of depth and connectivity, similar to a molecular structure or a data network.

Effect of transfer on lessor

Effect of transfer on lessor – rights against lessee

- Granting a lease creates two different relationships between lessor and lessee
 - Privity of estate
 - Privity of contract
- Some courts have held that, unless lease provides otherwise, lessee who assigns OGL remains liable for future breaches of contract obligations by assignee
 - *Seagull Energy E&P, Inc. v. Eland Energy, Inc.*, 207 S.W.3d 342 (Tex. 2006)
 - Court held that JOA provision that each party bears costs in proportion to ownership did not limit general rule that assignor remains liable for contractual rights and duties unless released
 - AAPL reacted to *Seagull* in its Model Form 610-2015 Operating Agreement

Effect of transfer on lessor – rights against lessee

- OGL forms usually modify the general rule by express contract provision
 - Example: “In case Lessee assigns this lease, in whole or in part, Lessee shall be relieved of all obligations with respect to the assigned portion or portions upon furnishing the Lessor with a written transfer or assignment or a true copy thereof.”
 - Example: “In the event of assignment hereof in whole or in part, liability for breach of any obligation issued hereunder shall rest exclusively upon the owner of this Lease, or portion thereof, who commits such breach.”
 - Example: “If all or any part of this lease is assigned, no act or omission of any leasehold owner shall affect the rights or liabilities of any other such owner,…”
 - Example: “Upon such assignment, Lessee shall be relieved of any obligation, payment or liability thereafter to accrue to the assigned portion of the lease.”
- Such provisions effectively act as an advanced novation
- Courts generally limit exculpatory effect to post-transfer breaches

Effect of transfer on lessor – further rights against assignee

- OGL obligations are covenants that run with the land (leased premises)
 - A covenant runs with the land if:
 - The original parties (lessor and lessee) intended it to run with the land
 - The covenant pertains to matters that “touch and concern” the land
 - Privity of estate exists between lessor and assignee
- The assignment/sublease distinction
 - Assignment transfers entire leasehold interest in some or all of leased premises, while sublease transfers less than entire interest
 - If transfer is a sublease, lessor does not have privity of estate with sublessee so that lessor’s rights remain against lessee/sublessor, and sublessee owes obligations to sublessor instead of lessor
 - The distinction does not depend upon what the parties call the transfer
 - Courts are divided on whether the retention of ORRI makes a transfer a sublease
 - *Compare Willis v. Int’l Oil & Gas Corp.*, 541 So.2d 332 (La. App. 1989)(ORRI retention = sublease) with *Holman v. State*, 438 N.W.2d 534 (N.D. 1989)(ORRI retention alone ≠ sublease)

The background is a dark blue field filled with a complex network of thin, light blue lines connecting small, glowing blue dots. The dots are scattered across the frame, with some acting as central hubs from which multiple lines radiate outwards. The overall effect is one of a dynamic, interconnected digital or neural network.

Rights and duties of lessee and assignee

Rights and duties of lessee and assignee

- Non-operating (or passive-income) interests are frequently created by assignments
 - Overriding royalty interests
 - Production payments
 - Net profits interests
 - Carried working interests
 - Convertible interests (e.g., before payout, interest is ORRI; after payment, converts to WI)
- Courts are divided on whether such interests are protected by implied covenants, such as the implied covenant to market or the implied covenant to protect against drainage

Rights and duties of lessee and assignee – washout

- *Sawyer v. Guthrie*, 215 F.Supp.2d 1254 (D. Wyo. 2002), describes “washout” as “intentional termination of lease to destroy a nonoperating interest” and “conduct by an operator designed to extinguish the overriding royalty interest while at the same time preserving the operator’s interest”
- Example: Anderson grants OGL to Weststar, who then assigns OGL to Ewing, retaining an ORRI, and then Ewing terminates the OGL (or permits it to expire) and obtains a new OGL from Anderson, free and clear of Weststar’s ORRI
 - Weststar’s ORRI has suffered a “washout”
- General rule: ORRI is not protected against washout unless there is an express provision in the assignment providing that it extends to the replacement OGL
 - Some courts recognize the possible existence of a “bad-faith” exception to the general rule

Rights and duties of lessee and assignee – washout

- Assignments protect against “washout” through express contract provisions
 - Reassignment clause
 - Example: “[Assignee] will not surrender, abandon, or otherwise permit or cause the Lease to terminate until [Assignee] has offered to reassign the Lease to [Assignor]. [Assignee] will make its reassignment offer at least thirty (30) days prior to any action or inaction by [Assignee] which could terminate the Lease. If [Assignor] elects to have the Lease reassigned to it, [Assignee] will immediately prepare an assignment of the Lease...”
 - “Extensions and renewals” clause
 - Example: “The Assignor herein hereby expressly excepts, reserves, and retains title to [the ORRI] under the provisions of the aforesaid lease, or any extension or renewal thereof, as an overriding royalty...”
- What about a clause that extends ORRI to new leases?
 - *Marquette ORRI Holdings, LLC v. Ascent Res.-Utica, LLC*, 199 N.E.3d 199 (Ohio App. 2022)
 - *Yowell v. Granite Operating Co.*, 620 S.W.3d 335 (Tex. 2020)

The background is a dark blue field filled with a complex network of thin, light blue lines connecting various points. These points are represented by small, bright blue dots of varying sizes, some of which are slightly blurred, creating a sense of depth and movement. The overall effect is reminiscent of a digital network, a molecular structure, or a star map.

“Wellbore” assignments

“Wellbore” assignments

- Example: *Plano Petroleum, LLC v. GHK Expl., L.P.*, 250 P.3d 328 (Okla. 2011)
 - In 2002, Assignors assigned to Clydesdale the following in the Newell OGL:
 - “[A]ll right, title and interest in and to that certain wellbore, all leasehold, limited in depth from the surface of the earth to the base of the Tonkawa Formation, and all surface and subsurface equipment and materials thereon and therein, more particularly described as the Claude E. Newell #1 well. Said leases and well located in the northwest quarter of Section 23-17N-25W, Roger Mills County, Oklahoma, which wellbore, leases and associated equipment and materials so specified are hereinafter referred to as “SAID WELL.”
 - In 2008, Assignors assigned to GHK other interests in the Newell OGL, subject to the following exception:
 - “[T]hose rights thereunder pertaining to the well bore and the well bore only of the Newell # 1 well located in the E/2 NW/4 of Section 23-17N-25W,...if any, which were assigned and conveyed by that certain Assignment between [Assignors] and Clydesdale...as Assignee, dated November 30, 2002.”
 - Also in 2008, Clydesdale assigned its interest in the Newell OGL to Plano

“Wellbore” assignments

- Example: *Plano Petroleum, LLC v. GHK Expl., L.P.*, 250 P.3d 328 (Okla. 2011)
 - Plano and GHK sued each other to quiet title to the Newell OGL and each moved for summary judgment
 - District court ruled in favor of Plano and held that 2002 assignment assigned the entire Newell OGL and that the 2008 assignment to GHK transferred nothing
 - A divided Court of Civil Appeals affirmed
 - Supreme Court reversed and held that the 2002 assignment was patently ambiguous
 - Suggested five different ways it could be read:
 - Wellbore only assignment of the Newell #1 well with leasehold rights insofar as the Newell #1 well and all production therefrom (GHK’s argument)
 - Assignment of entire Newell OGL leasehold (Plano’s argument)
 - Assignment of leasehold of 80 acres in quarter section that contains Newell #1 well
 - Assignment of leasehold of 80 acres in quarter section that contains Newell #1 well limited in depth to base of Tonkawa formation
 - Assignment of entire Newell OGL leasehold limited in depth to base of Tonkawa formation

“Wellbore” assignments

- Example: *Sabre Energy Corp. v. Gulfport Energy Corp.*, 2024 U.S. App. LEXIS 20143 (6th Cir. 2024)(2-1 decision)
 - 1993 Assignment of ORRIs in 25 vertical shallow wells contained following provision:
 - “THIS ASSIGNMENT OF OVERRIDING ROYALTY INTEREST PERTAINS TO THE AFOREMENTIONED WELLS AND DRILLING UNITS ASSOCIATED THEREWITH AND DOES NOT EXTEND TO THE UNDRILLED ACREAGE ASSOCIATED WITH THE LEASE REFERENCED AND/OR POOLING AGREEMENT.”
 - Court of Appeals affirmed district court decision that “drilling unit” limited assignment’s scope to depths permitted under Ohio spacing rules in effect at time of assignment
- Example: *Hogue v. PP&G Oil Co., LLC*, 249 N.E.3d 334 (Ohio App. 2024)
 - 2007 Assignment of WI in four wells “and the related 20 acre drill site unit, together with the rights incident thereto and the personal property therein.”
 - Applying approach similar to *Sabre*, appeals court reversed trial court and held that assignment was unambiguously limited to the depths to which a well could have been drilled under spacing requirements in effect at time of assignment, which would have been 2,000-4,000 feet

Questions?



Andy Graham

andy.graham@step toe-johnson.com
(304) 598-8161

Disclaimer

These materials are public information and have been prepared solely for educational purposes. These materials reflect only the personal views of the author and are not individualized legal advice. It is understood that each case and/or matter is fact-specific, and that the appropriate solution in any case and/or matter will vary. Therefore, these materials may or may not be relevant to any particular situation. Thus, the presenter and Steptoe & Johnson PLLC cannot be bound either philosophically or as representatives of their various present and future clients to the comments expressed in these materials. The presentation of these materials does not establish any form of attorney-client relationship with the authors or Steptoe & Johnson PLLC. While every attempt was made to ensure that these materials are accurate, errors or omissions may be contained therein, for which any liability is disclaimed.

