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ARE OVERRIDING ROYALTY INTERESTS BECOMING THE CLAY PIGEONS OF THE TEXAS OIL AND GAS INDUSTRY? THE ASSIGNOR-ASSIGNEE RELATIONSHIP AFTER *SASSER v. DANTEX OIL & GAS*

INTRODUCTION

Consider the following scenario. Young Oil Company is a small oil exploration company that has generated a drilling prospect.[1] Young controls a block of leases around the prospect on which it hopes to get a wildcat[2] well drilled. The company has exhausted most of its working capital on lease and geological outlays. Financially strapped, Young is unable to afford the cost of drilling and will have to find someone else to drill the well. Young decides to farmout[3] the prospect; in return for a commitment from another company to drill a well, Young will assign[4] its leases to the other company, subject to a reservation of a proportion of the oil and gas that may be produced. This reserved proportion is an overriding royalty.[5] Young's marketing is successful and it assigns the lease to Black-Gold Oil Company, with the reservation of an overriding royalty of one-sixteenth of the working interest in the original leases. In the last year of the primary term[6] of the lease, Black-Gold, the new lessee, permits the lease to terminate and then subsequently re-leases the property. The issue arises:

1. A drillling prospect is a block of leases or a concept supported by a knowledge of geology defining a geographic area where the discovery of an oil field is possible. *See* HOWARD R. WILLIAMS & CHARLES J. MEYERS, MANUAL OF OIL AND GAS TERMS 885 (9th ed. 1994).

2. A wildcat well is "[a]n exploratory well being drilled in unproven territory, that is, in a horizon from which there is no [petroleum] production in the general area." *Id.* at 1218.

3. Williams & Meyers describes a farmout agreement as follows:

> A very common form of agreement between operators, whereby a lease owner not desirous of drilling at the time agrees to assign the lease, or some portion of it . . . to another operator who is desirous of drilling the tract. . . . The primary characteristic of the farmout is the obligation of the assignee to drill one or more wells on the assigned acreage as a prerequisite to completion of the transfer to him.

Id. at 389 (citations omitted).

4. An assignment is one of the standard conveyances of mineral interests by which all or partial interest in an original lease are conveyed to the participant in an oil deal. *See id.* at 62.

5. For a discussion considering the nature of the overriding royalty interest, see *infra* notes 16-19 and accompanying text.

6. A primary term is a contractually determined period of time during which an oil and gas lease may remain operative even though there is no production of oil or gas in paying quantities, provided drilling operations are commenced or rental payments are paid. *See* WILLIAMS & MEYERS, *supra* note 1, at 844.

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Will the override of Young Oil Company be imposed upon the new lease negotiated by Black-Gold?

The answer in Texas appears to be no. *Sunac Petroleum Corp. v. Parkes*[7] is the leading Texas case on the relationship between an assignor-overriding royalty owner and an assignee-working interest[8] owner in this context. In this case, the Texas Supreme Court was called upon to determine the extent to which the owner of an overriding royalty interest could be protected against attempts by a lease operator[9] to extinguish the overriding royalty owner's nonoperating interest.[10] The *Sunac* Court examined the effect of a provision found in the assignment creating the overriding royalty that purported to extend the life of the override to lease renewals and extensions. The judicial treatment given this issue by the *Sunac* Court, and by Texas courts in a series of related cases following *Sunac*, leads ultimately to the conclusion that Texas courts are (1) limiting the use of such provisions by narrowly interpreting the situations in which a subsequent lease procured by an assignee will be treated as a renewal or extension of the original lease, and (2) narrowly interpreting the circumstances in which use of the assignment clause or a preexisting relationship between the parties will serve as an effective method of imposing a fiduciary obligation to protect the interests of overriding royalty owners against washouts.[11]

The most recent case to consider this issue is *Sasser v. Dantex Oil & Gas, Inc.*[12] In *Sasser*, the San Antonio Court of Appeals examined the effect on Sasser's overriding royalty under a 1974 lease when the lessor and lessee entered into a new lease in 1990.[13] Distinguishing *Sasser* from previous Texas cases that considered this issue is the fact that the lessee *intentionally* acted to terminate a *productive* lease so as to extinguish the non-cost-bearing overriding royalty interest dependent upon the earlier lease.[14] Following the *Sunac* Court's approach to this issue, the *Sasser* court held that the new lease had the effect of

7. 416 S.W.2d 798 (Tex. 1967).

8. The working interest, also known as the operating interest, provides "the exclusive right to exploit the minerals on the land." *See* WILLIAMS & MEYERS, *supra* note 1, at 1225.

9. A lease operator, the owner of the operating interest, "is burdened with the cost of development and operationg [sic] of the property." *See* WILLIAMS & MEYERS, *supra* note 1, at 746.

10. A nonoperating interest is "[a]n interest in production from a mineral property which does not share in operating rights, *e.g.*, . . . *an overriding royalty* [interest]." *Id.* at 701.

11. For a discussion of the relevant issues, see *infra* notes 21-23 and accompanying text.

12. 906 S.W.2d 599 (Tex. App.—San Antonio 1995, no writ).

13. *See id.* at 601.

14. *See id.* at 607.

terminating the old lease and of consequently extinguishing Sasser's override.[15]

In reaching its decision, the San Antonio Court of Appeals effectively broadens the reach of *Sunac* to extend to situations in which the lessee may intentionally terminate a lease, even a commercially productive lease, and, in the process, extinguish an override owner's interest. Arguably, the broadening of *Sunac* by the *Sasser* court, which is unsupported by the reasoning of *Sunac* itself, as well as by post-*Sunac* decisions, may have far reaching and serious implications for the Texas oil and gas industry.[16]

I. BACKGROUND OF THE LAW

A. *Introduction*

1. Overriding Royalty Interests

In oil and gas law, there are several types of royalty interests.[17] One such interest is the overriding royalty interest. In Texas, "[t]he term 'overriding royalty' has a well-defined meaning . . . . It is an interest which is carved out of, and constitutes a part of, the working interest created by an oil and gas lease."[18] The lessee may retain such an interest in himself if he assigns all or part of the lease, or he may transfer such an interest as a means of providing compensation for services.[19] Normally, Texas courts have held that "[a]n overriding roy-

15. *See id.*

16. *See infra* notes 121-25 and accompanying text.

17. *See generally* Schlittler v. Smith, 101 S.W.2d 543, 544 (Tex. 1937) ("The word[ ] 'royalty[ ]' . . . [has] a well-understood meaning in the oil and gas business. . . . Broadly speaking, a reservation of minerals or mineral rights without limitation would include royalties . . . ."); WILLIAMS & MEYERS, *supra* note 1, at 970 (defining royalty as a right that entitles the owner of the interest to a "share of production, free of expenses of production").

18. Gruss v. Cummins, 329 S.W.2d 496, 501 (Tex. Civ. App.—El Paso 1959, writ ref'd n.r.e). Martin and Kramer provide the following illustration:

> Typically, . . . the term overriding royalty is used to describe a royalty carved out of the working interest created by an oil and gas lease. Most frequently it is created subsequent to a lease by grant or reservation. For example, the original lessee may transfer the leasehold, or some part thereof, retaining a 1/16 overriding royalty—an override created by reservation—or the lessee may transfer a 1/16 overriding royalty for a valuable consideration—an override created by grant. . . . Overriding royalties are perhaps created more often by reservation than by grant. The usual occasion for the reservation of an override is the transfer of a lease or a portion thereof, the lessee-assignor retaining an interest in production from the assigned lease in the form of an overriding royalty . . . .

PATRICK H. MARTIN & BRUCE M. KRAMER, WILLIAMS & MEYERS: OIL AND GAS LAW § 418.1, at 351 (1997).

19. *See* 3 W.L. SUMMERS, THE LAW OF OIL AND GAS § 554, at 625-26 (2d ed. 1958). The reasons for such assignments are as varied as the types available. Overriding royalty interests are frequently used to compensate the geologist who developed the prospect, the landman who took the lease, or others who performed service for the Lessee and have helped to structure a drilling venture. *See id.* Also, "an overrid-

alty interest, because it is carved out of a leasehold interest, is limited in duration to the leasehold interest's life, and the termination of that leasehold estate extinguishes the overriding royalty."[20] This is the case generally, unless "the instrument creating the overriding royalty interest makes [an] express provision to the contrary."[21]

2. Extension-Renewal Clause

A common form of protective clause used in the instruments creating an overriding royalty is an "extension or renewal" clause. The clause, as a contract term, is a provision in a lease assignment that extends the overriding royalty interest to renewals and extensions of the original lease.[22] An "extension or renewal" clause is commonly included in an oil and gas lease assignment as an anti-washout provision designed to extend the overriding royalty interest to new leases obtained on the same property by the same lessee.[23] A washout occurs when "[a]n operator . . . intentionally terminate[s] the lease and obtain[s] a new lease on the same property in order to destroy the nonoperating interests."[24]

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ing royalty may be created by grant as consideration for . . . the financing of drilling operations." MARTIN & KRAMER, *supra* note 18, § 418.1, at 351. "[L]ease assignments quite commonly occur in the context of a farmout agreement. . . . Typically an oil company that has a lease . . . may transfer its interest . . . to an operator who agrees to drill a well to a specified depth and at a specified location on the acreage transferred." EUGENE O. KUNTZ ET AL., OIL AND GAS LAW 604 (2d ed. 1993).

20. *In re* GHR Energy Corp., 972 F.2d 96, 99 (5th Cir. 1992) (citing Sunac Petroleum Corp. v. Parkes, 416 S.W.2d 798, 804 (Tex. 1967)).

21. Keese v. Continental Pipe Line Co., 235 F.2d 386, 388 (5th Cir. 1956).

22. *See* MARTIN & KRAMER, *supra* note 16, § 428.1, at 468. The authors explain as follows:

> A common contractual provision for the protection of the owner of a nonoperating interest takes the form of an extension and renewal clause 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.

Id. See also EUGENE KUNTZ, A TREATISE ON THE LAW OF OIL AND GAS § 63.2 (1991) ("[T]he instrument by which the interest is created may provide that the overriding royalty will apply to modifications, renewals, and extensions of the lease."); *cf.* Bruce A. Ney, *Protecting Overriding Royalty Interests in Oil and Gas Leases: Are the Courts Moving to Washout Extension or Renewal Clauses?* 31 WASHBURN L.J. 544, 549 (1992) (noting that the clause, to be effective, must appear in the instrument creating the overriding royalty interest).

23. *See* MARTIN & KRAMER, *supra* note 18, § 428.1, at 469-70 & n.4 ("The purpose of the extension-renewal clause is to prevent what is known as a "wash-out," that is, the elimination of an override or other share of the working interest by the surrender of the lease and subsequent reacquisition of a lease on the same land, free of such interest.") (citation omitted). *See also* Otter Oil Co. v. Exxon Co., U.S.A., 834 F.2d 531, 533 (5th Cir. 1987) (noting that purpose of extension and renewal clause was to prevent washout).

24. Ney, *supra* note 22, at 546 (alterations in original) (quoting David E. Pierce, *An Analytical Approach To Drafting Assignments*, 44 Sw. L.J. 943, 968 (1990)). Ney goes on to explain as follows:

Some commentators have observed that, "[t]heoretically, the overriding royalty interest should attach to any modifications, extensions, or renewals occurring while the original lease is still effective regardless of whether the instrument contained an extension or renewal clause."[25] Under Texas law, however, this is clearly not the case. As the Court in *Sunac* explained, unless the instrument creating the overriding royalty expressly provides to the contrary, "when an oil and gas lease terminates, the overriding royalty created in an assignment of the lease is likewise extinguished."[26]

Accepting, for the moment, that an express provision in an oil and gas lease assignment that extends the overriding royalty to all renewals and extensions is, in principle, necessary for the interest to apply to any renewals and extensions of the original lease, the next question to consider is whether the inclusion of such a clause has, in practice, provided effective protection for overriding royalty interest owners against attempts to extinguish their interest.

B. *The Current Status of the Law: The* Sunac *Two-Step Approach*

The leading Texas case on the relationship between a lessee and an overriding royalty interest owner in this context is *Sunac.* In *Sunac,* and in post-*Sunac* decisions, a clear trend has been established that Texas courts are moving to limit the utility of "renewal or extension" provisions in oil and gas contracts by restricting the situations in which the presence of a renewal or extension clause in the original lease will cause an overriding royalty to attach to a subsequent lease.[27] Texas courts since *Sunac* have narrowly interpreted the situations in which a

> A washout of an overriding royalty interest may be accomplished in one of two ways. The first method involves the operator's procurement of a top lease prior to the expiration of the primary term of the bottom lease covering the same acreage. The second form of washout occurs through the termination of the existing lease and the subsequent execution of a new lease or leases covering the same acreage.

Id. at 546-47 (citations omitted). *See also* MARTIN & KRAMER, *supra* note 18, § 420.2, at 362 (explaining that a washout "concerns conduct of the operator designed to extinguish the nonoperating interest while preserving the operator's interest in the premises").

25. Ney, *supra* note 22, at 549 (noting that "'[i]n such a situation the lease out of which the interest was carved still exists and there is no reason why it should not continue to be subject to the overriding royalty.'") (quoting EUGENE KUNTZ, A TREATISE ON THE LAW OF OIL AND GAS § 63.2 (1991)).

26. Sunac Petroleum Corp. v. Parkes, 416 S.W.2d 798, 804 (Tex. 1967).

27. *See id.* at 803-04 (holding that a new lease was not a renewal and extension of the original lease, and declining to impose a fiduciary relationship between the lessee and the overriding royalty interest owner based on the renewal and extension clause contained in the lease assignment). *See generally* Exploration Co. v. Vega Oil & Gas Co., 843 S.W.2d 123, 127 (Tex. App.—Houston [14th Dist.] 1992, writ denied) (declining to impose fiduciary duty on lessee despite fact that assignment contained clause providing that overriding royalty interest would apply to all renewals and extensions of lease); McCormick v. Krueger, 593 S.W.2d 729, 729-30 (Tex. Civ. App.—Houston [1st Dist.] 1979, writ ref'd n.r.e.) (rejecting a claim that a new lease was a continuation

subsequent lease will be treated as a renewal or extension of the original lease[28] and have consistently declined to impose a fiduciary relationship on the parties by reason of such a provision.[29]

In *Sunac*, and in post-*Sunac* decisions involving lease assignments extending the overriding royalty to all renewals and extensions, the approach taken has been a two-step process: (1) to determine whether the later lease was an "extension or renewal" of the prior lease, or a "new" lease; and, (2) if determined to be a "new" lease, then to consider whether that lease should be treated as an extension or renewal of the original lease under a constructive trust theory, such that the overriding royalty interest continued.

1. Extension or Renewal, or New Lease

Perhaps the most formidable obstacle to attempts in Texas courts to protect overriding royalty interests through the use of extension or renewal clauses has been the trend—established in *Sunac*, and followed in post-*Sunac* decisions—to narrowly construe the terms "extension" and "renewal" to find that a subsequent lease is not an extension or renewal of the former lease, but is instead a "new" lease, free of the burden of the overriding royalty reserved under the old lease.

In *Sunac*, the Texas Supreme Court considered whether the inclusion of an extension or renewal provision in an oil and gas lease assignment that reserved an overriding royalty interest for the assignor caused the override to attach to a subsequent lease.[30] The assignment that reserved the overriding royalty in the assignor contained a provision imposing the overriding royalty on "production from the lease, or from any extension or renewal thereof."[31] After questions arose regarding the termination of the original lease, the lease operator and lessor executed a second lease but failed to provide for the existing overriding royalty interest.[32] The defendant/assignee argued that the override had not attached to the subsequent lease. He maintained that the first lease containing the overriding royalty reservation had terminated under its own terms and that the second lease was not an extension or renewal of the original lease.[33] The Court agreed, holding that the second lease was not an extension or renewal of the original lease.[34] Several factors were relied upon in reaching this conclusion.

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of a former lease despite language extending the overriding royalty to all renewals and extensions).

28. *See infra* notes 37-46 and accompanying text.
29. *See infra* notes 53-63, 79 and accompanying text.
30. *See Sunac*, 416 S.W.2d at 799.
31. *See id.*
32. *See id.* at 800.
33. *See id.* at 799.
34. *See id.* at 803.

The Court first considered whether the original lease was still in effect so as to preserve the overriding royalty interest under the specific terms contained in the assignment of the lease. Finding that there was neither production from, nor operations upon, the lease acreage to extend the lease beyond its primary term, the *Sunac* Court held that the initial lease in question terminated under its own provisions at the time the primary term of the lease ended.[35]

The Court next considered whether the second lease was a *new* lease and thus not subject to the provisions of the assignment in the expired lease, or conversely, whether the *extension* or *renewal* of the earlier lease, by virtue of the extension or renewal clause in the original lease assignment, bound the lessee to honor the assignor's overriding royalty interest.[36] The Court construed the terms "extension" and "renewal" and held that the second lease was not an extension or renewal of the first lease, but a "new" lease instead. In reaching its decision, the Court first examined whether the new lease was an "extension" of the old lease.[37] The *Sunac* Court, finding that an option for extension contemplates a continuance of an old lease for a further period, held that the second lease did not constitute an extension of the old lease since the second lease was not a "prolongation or continuation of the term of the existing lease."[38] The Court next analyzed whether the second lease might be considered as a "renewal" of the first lease.[39] Finding that an option for renewal implies the giving of a new lease upon the same terms as the old lease, the Court held that the second lease was not a renewal of the original, because (1) the second lease was entered into after the original lease had long since expired,[40] and (2) the operator obtained the second lease on terms

35. *See id.* at 802.

36. *See id.*

37. *See id.*

38. *Id.* (citing Mutual Paper Co. v. Hoague-Sprague Corp., 8 N.E.2d 802 (Mass. 1937)).

39. *See id.*

40. *See id.* (finding that the second lease was not acquired until at least a year after the old lease had expired). The question naturally arises, how much—or conversely, how little—time is sufficient before Texas courts conclude that a second lease will no longer be considered a renewal of the original? In support of its decision, the *Sunac* Court cites *Thomas v. Warner-Quinlan*, 65 S.W.2d 321 (Tex. Civ. App.—Eastland 1933, writ ref'd). *See id.* at 805. In Thomas, the assignor of oil and gas leases contended that a new lease taken by the assignee on the same land *thirty-one days* after the old lease had expired was in legal effect a renewal of the former lease, entitling the assignor to an overriding royalty interest in the current lease. *See Thomas*, 65 S.W.2d at 322-23. The terms of the contract of assignment extended the overriding royalty to all renewals and extensions. *See id.* at 321-22. Despite this language, the *Thomas* Court refused the assignor any relief holding, in part, that the assignee, "was under no duty to procure any renewal or extension of the first lease," even though, under the terms of the assignment, "had it done so, same would have enured to the benefit of the [assignor]." *Id.* at 325.

substantially different from those of the original lease.[41] Thus, having determined that the original lease containing the assignment reserving the overriding royalty interest had expired and that the subsequent lease constituted a "new" lease, being neither an extension nor a renewal of the former lease so as to perpetuate the overriding royalty interest, the Court held that the overriding royalty interest reserved in the original lease also had expired.[42]

Since the *Sunac* decision, Texas courts have applied the reasoning of *Sunac* and have consistently rejected claims that a subsequent lease was a renewal or extension of a former lease, thereby binding the new lessee to honor an overriding royalty interest. In *Exploration Co. v. Vega Oil & Gas Co.*,[43] the assignment creating the plaintiff's overriding royalty interest specifically provided that his overriding royalty would continue in any renewals or extensions of the original leases.[44] Citing *Sunac*, the court held that a new lease is not a "renewal or extension" of an expired lease "if the new lease was entered into after the old lease had already expired, new consideration exists to support the new lease, the new lease was executed under different circumstances, and the new lease contains different terms."[45] The plaintiff's case met none of the criteria; therefore, the court concluded that the new leases were not in renewal or extension of the expired leases.[46]

Similarly, in *McCormick v. Krueger*,[47] the Houston First Court of Appeals cited *Sunac* in rejecting a claim that a new lease was actually a renewal and extension of a former lease despite language extending the overriding royalty to all renewals and extensions and to new leases taken on the same land within one year of the expiration of the existing lease.[48] The *McCormick* Court held that the overriding royalty

41. *See Sunac*, 416 S.W.2d at 802-03. Specifically, new consideration existed to support the second lease; the later lease was executed under different circumstances, and the later lease contained different terms. *See id.*

42. *See id.* at 802-04.

43. 843 S.W.2d 123 (Tex. App.—Houston [14th Dist.] 1992, writ denied).

44. *See id.* at 124. The assignment included the following clause: "The overriding royalty interest herein reserved shall be binding upon and encumber all extensions and renewals of any of said leases hereafter secured by assignee, its successors or assigns." *Id.* When the original leases expired by nonproduction, the defendant acquired new oil and gas leases covering the same minerals as the old leases. *See id.* The plaintiff argued that the new oil and gas leases were actually a renewal and extension of the prior lease, and thereby covered by the assignment's language, entitling the plaintiff to an overriding royalty interest to be paid from the production from the current leases. *See id.* at 125. The court found that the original leases had terminated for lack of production in paying quantities, that the new leases were acquired more than a year after the old leases had expired, and that the new leases contained different terms from the original leases. *See id.* at 125-26

45. *Exploration Co.*, 843 S.W.2d at 125-26 (citing *Sunac*, 416 S.W.2d at 803).

46. *See id.* at 126.

47. 593 S.W.2d 729 (Tex. Civ. App.—Houston [1st Dist.] 1979, writ ref'd n.r.e.).

48. *Id.* at 729-30 (noting that the plaintiff reserved an overriding royalty interest "under and by virtue of the assigned leases or any extension thereof" and stipulated that the overriding royalty interest would extend to "all renewals and extensions of

had been extinguished with the expiration of the prior lease and that the current lessee was not obligated to honor the overriding royalty interest reserved under the subsequent lease agreement.[49]

Therefore, even though an oil and gas assignment may expressly provide that subsequent lease extensions and renewals are subject to an overriding royalty, Texas courts since *Sunac* have limited the use of such provisions by narrowly interpreting the situations in which a subsequent lease procured by an assignee will be treated as a renewal or extension of the original lease. If the second lease was made after the expiration of the original lease and contains substantially different terms from the original lease, Texas courts will not give effect to an extension or renewal clause. In these situations, the second lease will be deemed a new lease, unburdened by the overriding royalty reserved under the original lease, not an extension or renewal of the original lease.

2. Confidential or Fiduciary Relations

If a subsequent lease has first been determined to be a new lease and not an extension or renewal of an earlier lease, the second step of the approach established in *Sunac* is to consider whether the assignment of the oil and gas lease reserving the overriding royalty interest created any confidential or fiduciary relationship between the assignor and his assignee.[50] In Texas, "[i]t is . . . 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."[51] If such a relationship is created, however, a second lease may be treated as an extension or renewal of an original lease under a constructive trust theory so as to maintain the assignor's overriding royalty rights.[52] Acknowledging that other jurisdictions had so held,[53] the Texas Supreme Court in *Sunac* recognized two underlying principles for these holdings:

said leases or to any new lease taken on any of the lands covered by said leases within one (1) year of the expiration or termination of the applicable lease").

49. *See id.* at 731.

50. *See* Sunac Petroleum Corp. v. Parkes, 416 S.W.2d 798, 803-05 (Tex. 1967).

51. *Id.* at 804.

52. *See id.* at 803. The Court observed, "A constructive trust arises where there is a fiduciary or confidential relationship between two or more parties and the party holding certain property would profit by a wrong or be unjustly enriched if he were allowed to keep the property." *Id.* at 804 (citing Omohundro v. Matthews, 341 S.W.2d 401, 405 (Tex. 1960)).

53. *See id.* at 803-04 (citing Probst v. Hughes, 286 P. 875 (Okla. 1930) and Howell v. Coop. Refinery Ass'n, 271 P.2d 271 (Kan. 1954) as examples where a second lease was treated as a renewal or extension of an original lease because the terms of the conveyance imposed upon the assignee the duty of protecting the interests of the assignor). *See generally* Ney, *supra* note 22, at 564-67 (examining the effectiveness of extension or renewal clauses in oil and gas lease assignments as the basis for imposing heightened or fiduciary obligations on the relationship between the assignor and assignee).

"either (1) specific language in the assignment or (2) the close relationship between the parties shown by the particular facts involved."[54]

a. Specific Language in the Assignment

In *Sunac*, the Texas Supreme Court noted that "[t]he language most often pointed to by the courts as creating a fiduciary relation in this type of situation provides that the overriding royalty will apply to any extensions or renewals of the lease assigned."[55] The assignment in *Sunac* that created the overriding royalty used such "phraseology."[56] However, in addition to the express inclusion in the lease assignment of a renewal or extension provision, the assignment also contained language—a "duty to develop and surrender" provision—that expressly relieved the assignee of any duty to develop the lease and allowed the assignee to surrender the lease at its option, without the overriding royalty owner's consent.[57] Construing the two provisions together, the *Sunac* Court declined to impose a fiduciary relationship between the lessee and the overriding royalty interest owner based on the renewal and extension clause contained in the assignment.[58] The Court remarked that it was the inclusion of the "duty to develop and surrender" provision that materially distinguished the case at bar from

54. *Sunac*, 416 S.W.2d at 803.

55. *Id.* at 804. As one commentator has expressed it, the clause may be used "indirectly" as a method to protect the interests of overriding royalty owners through the imposition of fiduciary obligations:

> In addition to the direct effect of an extension or renewal clause as a contract term, the clause has been found to have an indirect effect. Some courts have held that the inclusion of an extension or renewal clause supports the imposition of heightened or fiduciary obligations on the relationship between the operator of a lease and the overriding royalty owner.
>
> To allow the owners of overriding royalty interests to take advantage of this indirect effect, the inclusion of extension or renewal clauses in lease transfer agreements or assignments which create an overriding royalty interest has been encouraged as a means of providing the court with evidence of the parties' intent to form a fiduciary relationship. A court, finding that the protective clause created a fiduciary relationship between the operator and overriding royalty interest owner, may impress the overriding royalty on the post-washout lease through the imposition of a constructive trust.

Ney, *supra* note 22, at 550 (citations omitted).

56. *See Sunac*, 416 S.W.2d at 804. "The assignment provided, 'Assignor hereby reserves unto himself, his successors, heirs and assigns as a perpetual overriding royalty . . . 1/16 of 7/8 of all the oil, gas and/or casinghead gas, if, only, as and when produced, saved and sold from the premises covered by this lease, or any extensions or renewals thereof . . . .'" *Id.* at 806 n.1 (alteration in original).

57. *See id.* at 804. The court noted that the assignment contained the following provision that expressly relieved the assignee of any duty to develop the lease:

> 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.

Id.

58. *See id.*

cases relied upon by the plaintiff-assignor—cases that held that the express inclusion of an extension or renewal clause in a lease assignment was sufficient to impose a fiduciary obligation upon the assignee to protect the assignor's interest.[59]

Although the Texas Supreme Court in its *Sunac* opinion seemingly took a "four corners" approach[60] to support its conclusion that the specific language of the lease assignment was insufficient to impose fiduciary responsibilities upon the parties, it is not clear whether the Court gave preemptive weight to the "duty to develop and surrender" clause in reaching its decision. Thus, the *Sunac* Court leaves unanswered the question of whether the express inclusion of an extension or renewal clause in a lease assignment—in the absence of competing contractual provisions—is sufficient to impose fiduciary obligations upon the operator-assignee. The Court's decision does suggest, however, that the effect of the renewal or extension clause should at least be weighed and balanced, if not preempted, by countervailing provisions in the assignment.

In *Exploration Co. v. Vega Oil & Gas Co.*,[61] a recent post-*Sunac* decision, the Houston Fourteenth District Court of Appeals also had occasion to consider the effect of using an extension or renewal clause to protect an assignor's overriding royalty interest through the imposition of a constructive trust. In *Exploration Co.*, the plaintiff-assignor sought to impress a constructive trust in his favor on new leases taken by the defendant-assignee, arguing that the renewal and extension clause contained in the original lease assignment automatically created a fiduciary relationship between the plaintiff and defendant.[62] Unlike the assignment in *Sunac*, the lease assignment in *Exploration Co.* lacked any language negating the lessee's obligation to keep the lease in effect and contained no provisions abrogating a fiduciary duty.[63] Citing *Sunac*, the *Exploration Co.* Court observed that the presence of the "duty to develop and surrender" provision in the *Sunac* case was not material to the Texas Supreme Court's decision, but rather, that the *Sunac* Court's decision was merely "strengthened" by the inclusion of such language.[64] As a result, the court found that "[m]erely because this language is not in the lease in this case does not mean that a fiduciary relationship exists."[65] On this basis, the Hous-

59. *Id.*

60. *See* Bruce M. Kramer, *The Sisyphean Task of Interpreting Mineral Deeds and Leases: An Encyclopedia of Canons of Construction*, 24 TEX. TECH L. REV. 1, 66 (1993) (explaining that use of the canon allows courts to consider the language of the entire reservation in order to ascertain the intent of the parties and the meaning of the reservation).

61. 843 S.W.2d 123 (Tex. App.—Houston [14th Dist.] 1992, writ denied).

62. *See id.* at 126.

63. *See id.*

64. *See id.*

65. *Id.*

ton Court of Appeals held that a constructive trust should not be imposed, thereby requiring the recognition of the overriding royalty interest.[66]

Arguably, the decision in *Exploration Co.* gave an overly broad reading to the decision of the Texas Supreme Court in *Sunac* on this issue. While *Sunac* suggests that the effect of the renewal or extension clause to impose a fiduciary obligation on the assignee may be negated by countervailing provisions in the assignment, the Houston Court of Appeals' decision concludes that use of the clause will not create a confidential or fiduciary relationship between the assignor and assignee even in situations where countervailing language in the assignment to negate the alleged fiduciary obligation is absent.

Thus, in considering whether the inclusion of an extension or renewal clause in the instrument creating the overriding royalty creates any confidential or fiduciary relationship between the assignor and his assignee, Texas courts conclude that the use of the clause does not serve as an effective method of imposing a fiduciary obligation. At its most potent, the presence of the clause carries little weight against countervailing language that would negate the alleged fiduciary obligation. At its least potent, no such obligation exists, even in the absence of countervailing provisions.

b. Special Relationship Between the Parties

Evidence of a close or special relationship between the assignor and assignee, sufficient to create a fiduciary obligation apart from any express agreement to that effect, is the second basis under the *Sunac* decision to support a claim that a constructive trust should be imposed requiring the recognition of the overriding royalty interest.[67]

Having found no express language in the instrument creating the overriding royalty sufficient to support the imposition of fiduciary obligations between the operator of a lease and the overriding royalty owner, the court considered whether a fiduciary or confidential relationship existed between the parties to that instrument sufficient to give rise to a constructive trust.[68] The Court observed that "a constructive trust arises where there is a fiduciary or confidential relationship between two or more parties and the party holding certain property would profit by a wrong or be unjustly enriched if he were allowed to keep the property."[69] The *Sunac* Court, failing to find that any such relationship existed between the parties, declined to justify a constructive trust in the overriding royalty owner's favor.[70] The justification for the majority opinion was twofold: (1) the general rule that

66. *See id.* at 127.
67. *See* Sunac Petroleum Corp. v. Parkes, 416 S.W.2d 798, 803 (Tex. 1967).
68. *See id.* at 804.
69. *Id.* at 804 (citing Omohundro v. Matthews, 341 S.W.2d 401, 405 (Tex. 1960)).
70. *See id.* at 805.

the mere assignment of an oil and gas lease reserving an overriding royalty interest does not in itself create a confidential or fiduciary relationship between the assignor and assignee, and (2) the particular facts involved in this case did not indicate any "basis for a holding that there existed a confidential or fiduciary relationship."[71]

Three justices on the *Sunac* Court dissented on this issue, arguing that the second lease was an extension or renewal of the original lease.[72] The dissent contended that a fiduciary relationship was created between the assignor and the assignee "by reason of the peculiar circumstances existing at the time the new lease was taken."[73] The facts in the majority opinion indicated, in a perfunctory manner, that the new lease was taken only after the successors of the original lessor raised a question as to the validity of the original lease.[74] In contrast, the dissent's account of the facts called attention to the underlying implication that the lessors and lessees chose not to have a court determine the validity of the original lease but, instead, settled their differences by entering into a new lease to replace the questionable lease.[75] The dissent argued that, regardless of any preexisting confidential relationship between the parties or the presence of any extension or renewal language in the assignment, these particular facts were in *themselves* sufficient to create a fiduciary relationship between Sunac, the lessee, and Parkes, the overriding royalty interest owner.[76] In a strongly worded dissent, Justice Hamilton seemingly admonishes the court for perfunctorily dismissing the notion that no special, confidential or fiduciary relationship was involved, saying:

> When the question of invalidity of the lease was raised by the lessors to Sunac, Parkes' rights were involved just as were Sunac's. If Sunac had stood its ground and suffered a lawsuit, Parkes would have been an indispensable party defendant. Parkes had just as much right to settle with the lessors as did Sunac, but Parkes had no opportunity to settle. Sunac went behind his back and sold him out by taking a new lease and thereby releasing the old one. This sort of conduct should not be allowed to cut Parkes out.[77]

The argument advanced by the *Sunac* dissent raises a significant issue: in considering whether to impose a constructive trust, when and under what circumstances will the Texas courts recognize a fiduciary relationship? Six years later, in *Consolidated Gas & Equipment Co. v. Thompson*,[78] the Texas Supreme Court clarified its position on the issue. The *Thompson* Court held that for a constructive trust to arise,

71. *Id.* at 804-05.
72. *See id.* at 811 (Hamilton, J., dissenting).
73. *Id.*
74. *See Sunac*, 416 S.W.2d at 800.
75. *See id.* at 806 (Hamilton, J., dissenting).
76. *See id.* at 811.
77. *Id.*
78. 405 S.W.2d 333 (Tex. 1966).

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the evidence must establish "a fiduciary relationship before, and apart from, the agreement made the basis of the suit."[79] Further, the Court recognized that "a fiduciary relationship could arise . . . when, over a long period of time, the parties had worked together for the joint acquisition and development of property previous to the particular agreement sought to be enforced."[80] This statement appears to foreclose the possibility that the heightened relationship could be based upon other grounds.

One post-*Sunac* court has had occasion to consider the *Thompson* Court's basis for recognition of a fiduciary relationship. In addressing a claim that a constructive trust should be imposed requiring the recognition of an overriding royalty interest apart from any express agreement to that effect, the Houston Court of Appeals followed the two-step approach established in *Sunac* but applied the *Thompson* Court's grounds for determining whether a fiduciary relationship existed between the parties.[81] The court found no evidence of such a relationship on this basis and refused to impose a constructive trust.[82]

Thus, in considering the scope of circumstances in which evidence of a confidential or fiduciary relationship is effective to support a claim that a constructive trust should be imposed, the conclusion reached is that Texas courts are moving to limit those occasions in which a constructive trust will be found. In holding that evidence of any confidential or personal relationship between the parties could give rise to fiduciary responsibilities, the Texas Supreme Court in *Sunac* proscribed a rather broad test for determining when a constructive trust may be imposed. The Court's later decision in *Thompson*, however, significantly limited those circumstances under which a Texas court may impose a constructive trust: (1) by narrowly construing the type of relationships that will give rise to fiduciary obligations, and (2) by requiring that the fiduciary relationship be shown to have been in existence before, and apart from, the particular agreement sought to be enforced.

II. *SASSER V. DANTEX OIL & GAS, INC.*

Sasser v. Dantex Oil & Gas, Inc.[83] is the most recent of the short line of cases to consider the *Sunac* Court's approach to determine whether the owner of an overriding royalty interest was entitled to

79. *Id.* at 336.

80. *Id.* at 336-37 (noting that these relationships were exceptions arising apart from the typical cases of fiduciary relationship, such as attorney-client, partners, close family relationships, and joint adventurers).

81. *See* Exploration Co. v. Vega Oil & Gas Co., 843 S.W.2d 123, 126 (Tex. App.—Houston [14th Dist.] 1992, writ denied).

82. *See id.* at 127.

83. 906 S.W.2d 599 (Tex. App.—San Antonio 1995, no writ).

https://scholarship.law.tamu.edu/txwes-lr/vol5/iss2/5
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relief when confronted with an attempt by the lessee to eliminate or "washout" the interest.

A. *The Facts of the Case*

In *Sasser*, Dantex entered into an oil and gas lease in 1974 subject to an overriding royalty interest owned by Sasser.[84] The lease was maintained beyond its primary term by production from wells on the property, but by 1990, continuation of the lease became questionable.[85] Declining production raised concerns that the 1974 lease had expired because of the possibility that production was no longer in paying quantities.[86] Dantex attempted to ratify the 1974 lease, but the landowner, Newsom, refused.[87] Newsom wanted both a larger royalty and a commitment that Dantex would drill a horizontal well to increase production.[88] Dantex agreed to Newsom's terms, and in 1990, a new lease was signed and several successful horizontal wells were drilled.[89]

When Dantex refused to pay Sasser the overriding royalty from well production established under the 1990 oil and gas lease, Sasser alleged that the overriding royalty interest applicable to the 1974 lease continued to burden the subsequent 1990 lease.[90] He sued for a declaratory judgment, an accounting, and a money judgment for the royalties alleged to be due.[91] Alternatively he sought damages, alleging that by entering into the 1990 lease, Dantex breached its duty of good faith and fair dealing. Sasser argued that "'evolving principles of Texas law' mandate[d] the conclusion that an oil and gas lessee owes an overriding royalty interest owner a duty of good faith not to engage in intentional acts designed to eliminate or 'washout' the overriding royalty interest owner."[92]

B. *The Holding of the Case*

A summary judgment against Sasser was affirmed on appeal.[93] Finding that Dantex was not in a special or confidential relationship with the overriding royalty interest owners under the initial lease, the court held that Dantex owed Sasser no duty of good faith and fair dealing or any other fiduciary-type duty.[94] Consequently, the parties

84. *See id.* at 601.
85. *See id.*
86. *See id.*
87. *See id.*
88. *See id.*
89. *See id.*
90. *See id.*
91. *See id.*
92. *Id.* at 605-06.
93. *See id.* at 608.
94. *See id.* at 606-07. The *Sasser* Court noted dicta in a recent Fifth Circuit opinion in which the court of appeals suggested that it "might impose a duty of good faith and fair dealing 'if the facts . . . suggested that [the lessee] surrendered its interest in

were free to take any action that would extinguish the overriding royalty interest. The court considered whether the 1974 lease had terminated due to a lack of production in paying quantities.[95] The court found, however, that the fact was not material[96] and asserted that the release of the old lease with the consequent extinguishment of the override would have been effective even "assum[ing] . . . that there was production in paying quantities" under the old lease.[97]

C. *The* Sasser *Court's Analysis*

In reaching its decision, the San Antonio Court of Appeals applied the two-step approach taken by the Texas Supreme Court in *Sunac* to determine whether a constructive trust should be imposed to protect the overriding royalty owner based upon "either (1) specific language in the assignment or (2) the close relationship between the parties shown by the particular facts involved."[98]

First, the court considered whether Sasser's assignment to Dantex contained the magic "phraseology" to impose the overriding royalty on leases taken in renewal and extension.[99] The court found that the 1974 lease creating the reservation of Sasser's overriding royalty interest did not contain a contract term purporting to extend the overriding royalty to any modifications, renewals, or extensions of the 1974 lease.[100]

Next, applying the *Sunac* approach, the *Sasser* Court addressed whether a constructive trust should be imposed requiring the recognition of the overriding royalty interest. The court first considered whether the inclusion of any express language in the assignment created any confidential or fiduciary relationship between Sasser and Dantex such that Sasser's overriding royalty continued under the new lease.[101] The court noted that not only did the specific language in the assignment fail to contain an extension or renewal provision, but that it did expressly include a clause that allowed Dantex to surrender the lease at its option without Sasser's consent.[102] Citing *Sunac*, the *Sasser* Court observed that, under Texas law, inclusion of a unilateral surrender provision in an instrument creating an override is sufficient to negate an alleged fiduciary obligation created by an extension or

the lease to destroy the rights of the overriding royalty interest owner.'" *Id.* at 607 (alteration in original) (citing *In re* GHR Energy Corp., 979 F.2d 40, 41 (5th Cir. 1992)).

95. *See id.* at 603-04.

96. *See id.* at 604.

97. *See id.*

98. *See id.* at 606 (quoting Sunac Petroleum Corp. v. Parkes, 416 S.W.2d 798, 803 (Tex. 1967)).

99. *See id.*

100. *See id.*

101. *See id.* at 606.

102. *See id.*

renewal clause even if a protective clause is present.[103] On this basis, the court declined to employ this ground to justify that the 1990 lease should be treated as an extension or renewal of the 1974 lease.[104]

The court then considered the *Sunac* Court's second ground to justify a constructive trust:[105] "the close relationship between the parties shown by the particular facts involved."[106] Sasser cited *Manges v Guerra*[107] to urge the court to extend the fiduciary duty imposed upon an executive to a lessee in Dantex's position.[108] However, the *Sasser* Court declined to follow *Manges* and, instead, followed the reasoning in *Sunac* by reasserting the general rule that the mere assignment of an oil and gas lease reserving an overriding royalty interest does not in itself create a confidential or fiduciary relationship between the assignor and assignee.[109] The court, agreeing with the trial court, held that the relationship between Dantex and Sasser was a purely business relationship and that no evidence of a close or special relationship existed sufficient to create a fiduciary obligation that would suggest an exception to the general rule.[110]

Finally, the court considered Sasser's claim of bad faith on the part of Dantex. Sasser attempted to distinguish *Sunac*, because in *Sunac* the old lease terminated by its own terms, whereas in *Sasser*, Dantex intentionally terminated the 1974 lease in order to enter into the 1990 lease.[111] Sasser asserted that Dantex's intentional act to terminate the lease harmed him economically by extinguishing his interest in a productive lease.[112] In addition, Sasser argued that the San Antonio Court of Appeals had previously "granted relief to an overriding royalty interest owner who was harmed by the intentional acts of a leasehold owner."[113] The court rejected this argument because it found

103. *See id.* at 606; *cf.* Exploration Co. v. Vega Oil & Gas Co., 843 S.W.2d 123, 126 (Tex. App.—Houston [14th Dist.] 1992, writ denied) (declining to impose fiduciary duty on lessor even in absence of surrender clause).

104. *See id.*

105. *See id.*

106. *See id.* (quoting Sunac Petroleum Corp. v. Parkes, 416 S.W.2d 798, 803 (Tex. 1967)).

107. 673 S.W.2d 180 (Tex. 1984). Manges acquired the surface, ½ the minerals and all the executive rights in a south Texas ranch from the Guerras. *See id.* at 181. Thus, only Manges had the right to lease and the Guerras were dependent upon him to lease their interest on reasonable terms. Finding that Manges encumbered the Guerras' interest in the property, leased the property to himself for a nominal sum and engaged in other acts of self-dealing to the detriment of the Guerras, the Court held that Manges' conduct amounted to a breach of his fiduciary duty. *See id.* at 184.

108. *See Sasser*, 906 S.W.2d at 607.

109. *See id.* at 606-07.

110. *See id.* at 602, 607.

111. *See id.*

112. *See id.* at 601.

113. *Id.* at 607 (citing Cain v. Neumann, 316 S.W.2d 915 (Tex. Civ. App.—San Antonio 1958, no writ)). In Cain, a third party held an overriding royalty interest in a lease that by its own terms would continue as long as "oil, gas, or other minerals can be produced thereon." *Cain*, 316 S.W.2d at 918. The lessor and lessee purported to

that Dantex's actions were contractually permitted and there was no reason to deny Dantex of its contractual rights.[114] It held that when Dantex and Newsom signed the 1990 lease with the intent and understanding that doing so would effect the release of the 1974 lease, the subsequent lease effectively terminated the initial lease, along with the overriding royalty interest under that lease.[115]

D. *The* Sasser *Decision in View of Post-*Sunac *Law*

The *Sasser* case is clearly distinguishable from the post-*Sunac* decisions discussed above, insofar as the instrument creating the overriding royalty interest contained no provision extending the overriding royalty on leases taken in renewal and extension.[116] Thus, deliberation of the direct effects of the clause—whether the 1990 lease was indeed a "new" lease or an "extension or renewal" of the 1974 lease—was not even a question for the *Sasser* Court. Consequently, the principle impact of the *Sasser* decision in applying the *Sunac* approach to this issue is to extend our understanding of when a constructive trust may be imposed to protect the overriding royalty owner under current Texas law.

1. Further Limits the Occasions in Which a Constructive Trust will be Found

Having previously reached the conclusion in our survey of pre-*Sasser* cases that the presence of an extension or renewal clause in the instrument creating the overriding royalty carries little weight against countervailing language that would negate the alleged fiduciary obligation, it becomes even more clear in the light of the *Sasser* decision that if the assignment creating the overriding royalty does not contain the magic "phraseology" to impose the overriding royalty on leases taken in renewal and extension, "it is unlikely that the specific lan-

terminate the original lease and enter into a new lease that would effectively eliminate the overriding royalty owner's interest. *See id.* Nevertheless, production on the leased property never abated. *See id.* at 920. The facts in *Cain* suggested that the defending parties intentionally harmed the overriding royalty interest owner for their own unjustifiable benefit. *See id.* at 919. The court held that the parties had not terminated the original lease and that the overriding royalty interest survived. *See id.* at 921.

The *Sasser* Court distinguished Cain on the basis that the lease involved "did not contain a surrender clause nor a partial release clause." *Sasser*, 906 S.W.2d at 607 (quoting *Cain*, 316 S.W.2d at 920). The court explained that "it [was] this contractual right to unilaterally terminate the lease, coupled with the absence of any facts justifying the imposition of a confidential or fiduciary relationship, that conclusively defeat[ed] Sasser's duty argument." *Id.*

114. *See Sasser*, 906 S.W.2d 607. The court observed that "the method by which a lease is terminated—so long as it is contractually permitted—is a distinction without a difference." *Id.*

115. *See id.*

116. *See id.* at 606.

guage in the assignment will ever support a 'washout' claim."[117] As a general rule in Texas, "when an oil and gas lease terminates, the overriding royalty created in an assignment of the lease is likewise extinguished."[118] The *Sasser* decision follows this established Texas law in recognizing that the termination of the leasehold estate results in the extinguishment of the overriding royalty interest, unless the instrument creating the overriding royalty interest expressly provides to the contrary.

Finding no language in the instrument creating the overriding royalty interest which imposed a fiduciary obligation, the only basis under *Sunac* for the *Sasser* Court to have justified the imposition of a constructive trust would have been a holding that there existed a confidential or fiduciary relationship between the parties.[119] Despite evidence that the 1974 lease was intentionally terminated by the assignor, and despite the court's contention that the assignor's right to do so would be effective even assuming that there was commercial production under the existing lease, the court dismissed the notion that any confidential or fiduciary relationship existed between the parties.[120]

2. Extends Reach of *Sunac* Decision to Productive Leases

In reaching this holding, the San Antonio Court of Appeals effectively broadens the reach of the *Sunac* reasoning to extend to situations in which the lessee may *intentionally* terminate a lease—even a commercially productive lease—and, in the process, extinguish an override owner's interest, thereby interfering with the override's existing contractual relationship and possibly harming him economically.[121] For these reasons, the *Sasser* decision is disturbing. The effects of the decision may have far reaching and serious implications for the Texas oil and gas industry. As one commentator has observed:

> The case is remarkable. The court in effect holds that even *assuming* a base lease is productive, a landowner who wants more royalty and a lessee who wants at the least, peace from a landowner's lawsuit (if not a higher net revenue interest) are free to agree to wash out a non-executive overriding royalty interest if no special, confidential or fiduciary relationship is involved. . . . The lessee should have at least the minimal duty not to intentionally interfere with the override's existing relationship or intentionally destroy the override interest or to intentionally harm him. . . . An owner [of an overriding royalty interest] should have the right to be secure in the

117. Richard F. Brown, *Annual Survey of Texas Law: Oil, Gas and Mineral Law*, 49 SMU L. REV. 1177, 1185 (1996).
118. Sunac Petroleum Corp. v. Parkes, 416 S.W.2d 798, 804 (Tex. 1967).
119. *See Sasser*, 906 S.W.2d at 606-07 (citing *Sunac*, 416 S.W.2d at 804-05).
120. *See id.* at 607.
121. If no production is obtained, the royalty is worthless. However, if prolific production is found, an overriding royalty may be extremely valuable.

> knowledge that its interest will not be extinguished by the agreement of the lessor and lessee or the intentional act of a lessee (who has a financial incentive to release the old lease and take a new lease). The effect of [the *Sasser*] decision—that the lessor and lessee may agree to terminate even a *productive* lease and extinguish a third party interest without liability—is unsettling. . . . Even if the override is held to have been extinguished, a damage remedy should be available to an override owner whose interest, intentionally, was held out, at least in cases of a producing base lease.[122]

3. Conclusions

As we have seen, the effect of Texas Supreme Court's decisions in *Sunac* and the cases following *Sunac* has been to significantly narrow the scope of protection given to owners of overriding royalty interests against lease operators seeking to extinguish these interests. The outcome of these decisions has been to reduce the effectiveness of the extension or renewal clause as an anti-washout provision and to significantly limit those circumstances in which a Texas court will find a confidential or fiduciary relationship and impose a constructive trust requiring the recognition of an overriding royalty interest. Arguably, the broadening of *Sunac* by the *Sasser* Court to extend to the lessor and lessee the right to terminate intentionally even a productive lease and extinguish a third party interest is unsupported by the reasoning of *Sunac* itself, as well as the reasoning of post-*Sunac* decisions.

One commentator has noted that courts within the Tenth Circuit are, as a matter of policy, moving to restrict the effectiveness of renewal and extension clauses in oil and gas lease assignments.[123] These policy initiatives are motivated by concerns that the protection of overriding royalty interests, through extension or renewal clauses, "would prevent operators from acquiring new leases on property covered by an existing lease with an attached overriding royalty interest in extensions or renewals"[124] and would create "'an irrational impediment to the business of oil exploration and development.'"[125]

Although no such broad policy statement has been made by the Texas courts, the argument may be made that in view of the judicial treatment by Texas courts on this issue, the present trend of limiting the scope of protection afforded to overriding royalty interests sweeps more broadly than its possible justification. As one commentator has insightfully observed: "What must be considered is that overriding royalty owners are at the mercy of the lease operators . . . . [T]he

122. Melvin W. Cockrell, *Current Developments in Texas Oil and Gas Law*, 38-39 (Aug. 22, 1996) (unpublished paper for Review of Oil & Gas XI, Energy Law Section of the Dallas Bar Assoc.).

123. *See* Ney, *supra* note 22, at 544.

124. *Id.* at 570.

125. *Id.* (quoting Lillibridge v. Mesa Petroleum Co., 907 F.2d 1031, 1036 (10th Cir. 1990)).

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position of an overriding royalty owner 'holding . . . an overriding royalty under a lease in the hands of an . . . unscrupulous operator is a precarious one.' "[126]

What is needed in Texas is not a broad duty to protect all overriding interests in all cases, but an oil and gas lessee should at the least owe an overriding royalty interest owner a minimal duty of good faith not to engage in intentional acts designed to eliminate or "washout" the overriding royalty interest owner, particularly when the result is to enhance the lessee's interest.

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126. *Id.* at 571 (citation omitted).

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