A Primer on Overriding Royalties

Sara E. Mouldoux
I. Introduction

I begin by acknowledging that there are numerous articles on overriding royalties which I have drawn on for purposes of this paper. Here, I will attempt to define the term “overriding royalty,” compare the treatment of an overriding royalty interest with that of the lessor’s royalty, including enforcement of such interest, consider extension and renewal clauses and their importance in avoiding a so called “washout,” and comment on recent judicial decisions concerning overriding royalty interests in Louisiana and in other jurisdictions. Throughout this examination of an overriding royalty, the potential application of the articles of the Louisiana Mineral Code (La R.S. 31:1 et seq.) will be examined and considered.

II. The Nature of an “Overriding Royalty”

While the Louisiana Mineral Code does not specifically define the term “overriding royalty,” it is universally considered to be a “nonoperating interest that is carved out of (the) working interest of an oil and gas lease.” An overriding royalty is typically created by assignment or reservation and generally entitles the owner of the override to a specified share of the oil and gas produced under the terms of the lease, free and clear of drilling, completing and operating costs.


EUGENE KUNTZ, LAW OF OIL & GAS, §63.2, 217 (2009).

The assignment can be of a present and specific interest or a future interest to be acquired by the grantor. See, e.g., Wurzlow v. Placid Oil Co., 279 So.2d 749 (La. App. 1 Cir. 1973).


“One of the most important aspects of an ‘overriding royalty’ is that it is a ‘royalty,’ viz in absence of an express agreement to the contrary it is free of costs which the lessor’s royalty is free and subject to the costs to which the lessor’s royalty is subject.” WILLIAMS & MEYERS, OIL AND GAS LAW, 728 (rev. ed. 2008). (whether reserved by the lessor in a lease as in the earlier usage of the term or created by a subsequent instrument executed by

- 158 -
Since an overriding royalty is typically created out of an oil and gas lease, that overriding royalty is limited in duration to the life of the lease. Thus, an overriding royalty will terminate upon expiration of the lease out of which it is created. In Louisiana, that durational limit is expressly imposed by article 126 of the Louisiana Mineral Code which specifically states: "[a]n interest created out of the mineral lessee's interest is dependent on the continued existence of the lease." Overriding royalties and similar interests that are carved out of the working interest are deemed appendages of the working interest and are dependent upon the continued existence of the working interest out of which they are carved.

Though the Louisiana Mineral Code does not expressly define the term "overriding royalty," several article of the Mineral Code acknowledge such an interest and provide for a means to enforce same. Thus, an overriding royalty interest is considered a mineral right under Louisiana law and is subject to the Mineral Code. And, a mineral right is considered to be an incorporeal immovable and is alienable and heritable. Moreover, since an overriding royalty is an immovable, it can only be created, conveyed or assigned by an authentic act or an act under the lessee or the lessee's successor) "A holder of an overriding royalty participates in the gross value of the production but does not bear any cost of production. In comparison, a possessor of a working interest while sharing in the gross value of the production bears a proportionate share of production costs." La. Land & Exploration Co. v. Pennzoil Exploration and Prod. Co., 962 F. Supp. 908, 913 (E.D. La 1997).

5 "An outstanding characteristic of overriding royalty is that its duration is limited by the duration of the lease under which it is created." Williams & Meyers, at 730.

6 KUNTZ, supra note 2, at 227.


8 See id. cmt. (citing Fontenot v. Sun Oil Co., 243 So. 2d 783 (La. 1971); Arkansas Fuel Oil Co. v. Gary, 79 So.2d 869 (La. 1955); Ascher v. Midstates Oil Corp., 64 So. 2d 182 (La. 1953); and Wier v. Glassell, 44 So. 2d 882 (La. 1950)).

9 It is important to note that the Mineral Code does define the term "royalty" as it relates to the lessor's royalty or a mineral royalty created out of the lessor's interest. Article 213 specifically defines the term "royalty" as "any interest in production, or its value, from or attributable to land subject to a mineral lease, that is deliverable or payable to the lessor or others entitled to share therein" if "[s]uch interests in production or its value are "royalty," whether created by the lease or by separate instrument, if they comprise a part of the negotiated agreement resulting in execution of the lease." §31:213. Obviously, the great majority of overriding royalty interests would not qualify as a "royalty" if the underlined portion of the foregoing definition is applicable. In this author's judgment, either article 213 should be amended to delete that portion of the definition of a "royalty" or the term "overriding royalty" should be specifically defined in the Mineral Code.

10 See §§31:126 and 171.

11 §31:18; see also CLK Co., L.L.C. v. CXY Energy, Inc., 07-834 (La. App. 3 Cir. 12/19/07) 972 So.2d 1280, 1290 (acknowledging that "[a]n overriding royalty is an incorporeal immovable").
private signature. A mineral right's situs is deemed to be in the parish or parishes where the land burdened by the mineral right is located. All sales, contracts, and judgments affecting such rights are subject to the laws of registry. As with other mineral rights the sale of an overriding royalty is not subject to rescission for lesion beyond moiety. Another article of the Mineral Code which should be mentioned is Article 171 which allows a co-owner of the lessee's interest in a mineral lease to “create a dependent right such as an overriding royalty, production payment, net profits interest, or other non-operating interest out of his undivided interest without the consent of his co-owner.”

The term “overriding royalty” was once utilized to reflect an additional “royalty” paid to a mineral owner above and beyond the standard one-eighth (1/8) granted in consideration for the granting of the lease. However, through the evolution of the term in the oil and gas industry and related jurisprudence, the term “override” attached to a royalty paid to a lessor under a lease is no longer considered an “overriding royalty.” It is still a royalty in the sense that it is a nonoperating interest carved out of the working interest of a lease but some argue that it is simply an additional sum retained by the lessor.

It is important to note that aside from the “lessor's overriding royalty” discussed above, there are three ways in which an overriding royalty is created, namely through reservation, through conveyance, and by an obligation “to convey.” When an oil and gas lease is assigned by the original lessee to a third party and the original lessee reserves an override in that lease, Louisiana law considers such assignment a sublease. This distinction may be important as the obligations of a sublessee to its sub-lessee may be more onerous than that of the working interest owner to the overriding royalty holder.

LA. CIV. CODE ANN. art 1839 provides:

A transfer of immovable property must be made by authentic act or by act under private signature. Nevertheless, an oral transfer is valid between the parties when the property has been actually delivered and the transferor recognizes the transfer when interrogated on oath.

An instrument involving immovable property shall have effect against third persons only from the time it is filed for registry in the parish where the property is located.

Id.

§31:17.

§31:171.

Bond v. Midstates Oil Corp., 53 So. 2d 149 (1951). As noted recently by the Louisiana Second Circuit Court of Appeal in Pinnacle Operating Company, Inc v. ETTCO Enterprises, Inc., in Louisiana, when a lease is "assigned to another with a reservation of an interest such as an overriding royalty, it is deemed a sublease." 40-367 (La. App. 2 Cir. 10/26/05) 914 So.2d 1144, 1146, n. 4.
III. Obligations of Grantor to Overriding Royalty Owner

Under article 122 of the Mineral Code no fiduciary relationship exists between a mineral lessee and its lessor. The mineral lessee is, however, “bound to perform the contract in good faith and to develop and operate the property as a reasonably prudent operator.” Based on these two general obligations the courts in Louisiana have defined five specific implied obligations. They are:

(1) the obligation to develop known mineral producing formations in the manner of a reasonable, prudent operator; (2) the obligation to explore and test all portions of the leased premises after discovery of minerals in paying quantities in the manner of a reasonable, prudent operator; (3) the obligation to protect the leased property against drainage by wells located on neighboring property in the manner of a reasonable, prudent operator; (4) the obligation to produce and market minerals discovered capable of production in paying quantities in the manner of a reasonable, prudent operator; and (5) the obligation of the lessee to restore the surface of the lease premise on completion of operations where there is evidence of unreasonable or excessive use of the surface.

An important case on this topic under consideration is Tidelands Royalty “B” Corp. v. Gulf Oil Corp., authored by Judge Wisdom of the United States Court of Appeals for the Fifth Circuit. Judge Wisdom found that the implied obligations owed by a lessee to its lessor under a mineral lease were not applicable to the relationship between a lessee and an overriding royalty owner who acquired his interest by a separate assignment.

Gulf had granted to Tidelands by separate assignment an overriding royalty which covered certain areas in the Gulf of Mexico including Block 332 of the West Cameron Area off the Louisiana coast. Gulf also

---

17 §31:122.
18 Id.
19 See §31:122 cmt.; Terrebonne Parish Sch. Bd. v. Castex, 04-0968 (La. 1/19/05) 893 So. 2d 789, 801. Additionally, it has been suggested that there is an implied obligation of a lessee to fairly represent its lessor before regulatory agencies applicable in Louisiana although no court has addressed the issue to date. See John M. McCollam, A Primer for the Practice of Mineral Law under the New Louisiana Mineral Code, 50 Tul. L. Rev. 732, 804 (1976).
20 804 F.2d 1344 (5th Cir. 1987).
21 Id. at 1355. (“The relationship between the parties is neither that of a lessor and lessee nor that of an executive and nonexecutive. Nevertheless, an examination of the nature of the agreement in this case leads to the conclusion that Gulf’s implied duty towards Tidelands is only one of good faith — the standard of conduct implicit in an executive-nonexecutive relationship.”)
22 Id. at 1348. 43 U.S.C. §1333(a)(1), (2)(A) provides:
was the lessee of West Cameron Block 333 to which the plaintiff’s
override did not attach. After drilling a dry hole on Block 332, Gulf
completed a successful gas well on Block 333 and eventually built a
drilling platform on Block 333 from which five additional successful
wells were completed. At least two of the Block 333 wells were
draining a reservoir underlying both Block 333 and Block 332. Tidelands filed suit seeking damages from Gulf based on Gulf’s failure
to protect it from drainage under the alleged implied obligation to do
so. The district court found that the even though there was no mineral
lease between plaintiff and defendant, the “implied obligations attending
a mineral lease also attend overriding royalty interests."

On Appeal, the U.S. Fifth Circuit overturned the district court’s
ruling and held that the implied covenants of a mineral lease do not
attach to an overriding royalty interest. The court compared the
overriding royalty at issue to that of a mineral royalty created by a
landowner which “establishes an executive-nonexecutive relationship”
with the landowner (the executive interest owner) having the right to
grant leases and the mineral royalty owner (the nonexecutive interest
owner) not having the right to explore, develop, or lease the subject
tract. The court then found that Tidelands only had a “passive interest
in the tracts subject to its overriding royalty” and that it had no right to
“produce or explore for minerals.”

The court then contrasted that relationship with the lessor/lessee
relationship where the lessee assumes “an affirmative, implied obligation
to develop the leased premises” and “the lessor surrenders his exclusive
right to explore for and produce minerals in exchange for the lessee’s
obligation to develop and protect from drainage.” In considering article

To the extent that they are applicable and not inconsistent with this subchapter or
with other Federal laws and regulations of the Secretary now in effect or hereafter
adopted, the civil and criminal laws of each adjacent State, now in effect or
hereafter adopted, amended, or repealed are hereby declared to be the law of the
United States for that portion of the subsoil and seabed of the outer Continental
Shelf, and artificial islands and fixed structures erected thereon, which would be
within the area of the State if its boundaries were extended seaward to the outer
margin of the outer Continental Shelf.

23 Tidelands, 804 F.2d at 1348.
24 Id.
25 Id.
26 Id.
27 Id.
28 Id. at 1350.
29 Id.
30 Id.

- 162 -
109 of the Louisiana Mineral Code\textsuperscript{31} in its analysis of the obligations of Gulf to Tidelands, the court recognized:

The Mineral Code preserves the rule of earlier jurisprudence that the nonexecutive royalty interest is passive and not generally protected by any implied affirmative duties of the grantor of the right absent a lessor-lessee relationship. The royalty owner’s interest is speculative: a hope that the grantor’s own interest in securing production will, in fact, result in production from the tract burdened by the royalty. If this hope fails to materialize because of the grantors’ inaction, the royalty owner has no complaint. \textsuperscript{32}

The court did recognize that the grantor of a royalty interest “must act with good faith towards the interest of the royalty owner” but further found the grantor need not act unreasonably or against its own economic interest to fulfill the good faith obligations. \textsuperscript{33} Specifically, the court held, “[i]f the conduct of the grantor is supported by reasons other than merely the advantage of avoiding the royalty burden, the standard of good faith may be fulfilled even though the royalty owner is harmed.” \textsuperscript{34} The court further concluded that the obligation of good faith implicit in the relationship between Tidelands and Gulf did not “create an affirmative duty of Gulf to protect Tidelands’ interest” \textsuperscript{35} Thus, it reversed the district court and remanded the action for a determination of whether Gulf’s actions violated the good faith standard. \textsuperscript{36}

A question arises, however, relative to an overriding royalty interest which is created by the assignment of a lease with the reservation of an overriding royalty interest as opposed to the conveyance of an overriding royalty interest by a separate assignment. As noted above, in Louisiana, the assignment of a mineral lease with the reservation of an overriding royalty creates a sublessor/sublessee relationship. \textsuperscript{37} Therefore, an argument can be made that the implied covenants established under article 122 of the Mineral Code and Louisiana jurisprudence are

\textsuperscript{31} Article 109 of the Mineral Code provides:

The owner of an executive interest is not obligated to grant a mineral lease, but in doing so, he must act in good faith and in the same manner as a reasonably prudent landowner or servitude owner whose interest is not burdened by a nonexecutive interest.


\textsuperscript{32} 804 F.2d at 1352.

\textsuperscript{33} Id. at 1353.

\textsuperscript{34} Id.

\textsuperscript{35} Id.

\textsuperscript{36} Id. at 1355.

\textsuperscript{37} See Pinnacle Operating Co., 914 So.2d at 1146, n. 4.
applicable to that relationship. While some states have rejected this position,\textsuperscript{38} the issue is still unsettled in Louisiana in this author’s opinion.

IV. Enforcement of Overriding Royalties

The Louisiana Civil Code provides that a liberative prescription of three years applies to “an action to recover underpayments or overpayments of royalties from the production of minerals.”\textsuperscript{39} A question arises as to whether or not this liberative prescription period is applicable to claims for under or over payment of overriding royalties due to the definition of “royalty” provided in article 213 of the Mineral Code.\textsuperscript{40} The original enactment of the Louisiana Mineral Code included specific procedures for the enforcement of royalty obligations owed to a lessor under a mineral lease.\textsuperscript{41} The purpose of those articles was to “provide lessors with a meaningful remedy while simultaneously giving operators who have made substantial investments in producing properties the security of title which the nature and size of their investment deserves.”\textsuperscript{42} In 1982, similar provisions were added to the Louisiana Mineral Code to provide a specific manner in which to ensure payment of overriding royalties. These provisions are very similar to those for enforcing the payment of a lessor’s royalty but obviously do not include the harsh remedy of lease cancellation provided in article 140 as an overriding royalty is a passive interest in a lease.\textsuperscript{43}

Article 212.21 states that “[i]f the owner of a mineral production payment or a royalty owner other than a mineral lessor seeks relief for the failure of a mineral lessee to make timely or proper payment of royalties or other production payments, he must give his obligor written notice of such failure as a prerequisite to a judicial demand for damages.”\textsuperscript{44} Article 212.22 goes on to provide that “[t]he obligor shall have thirty days after receipt of the required notice within which to pay royalties or production payments due or to respond by stating in writing a

\textsuperscript{38} See, e.g., McNeill v. Peaker, 488 S.W. 2d 706 (Ark. 1973) (holding that Arkansas law does not recognize implied covenants on the part of an assignee of an oil and gas lease to an overriding royalty owner whose interest was created by reservation and who is not a lessor).
\textsuperscript{39} L.A. CIV. CODE ANN. art. 3494 (2010).
\textsuperscript{40} See supra note 9, regarding the need to define the term “overriding royalty.”
\textsuperscript{41} See §31:137-140.
\textsuperscript{42} §31:137 cmt.
\textsuperscript{43} §31:140 provides:

If the lessee fails to pay royalties due or fails to inform the lessor of a reasonable cause for failure to pay in response to the required notice, the court may award as damages double the amount of royalties due, interest on that sum from the date due, and a reasonable attorney's fee regardless of the cause for the original failure to pay royalties. The court may also dissolve the lease in its discretion.

\textsuperscript{44} §31:212.21.
reasonable cause for nonpayment." The effect of payment or nonpayment of the sums due or stating or failing to state a reasonable cause for nonpayment within this period is treated in Article 212.23 as follows:

A. If the obligor pays the royalties or production payments due plus the legal interest applicable from the date payment was due, the owner shall have no further claim with respect to those payments.

B. If the obligor fails to pay within thirty days from notice but states a reasonable cause for nonpayment, then damages shall be limited to legal interest on the amounts due from the date due.

C. If the obligor fails to pay and fails to state a reasonable cause for failure to pay in response to the notice, the court may award as damages double the amount due, legal interest on that sum from the date due, and a reasonable attorney's fee regardless of the cause of the original failure to pay.

There are only three reported decisions in Louisiana which even reference these articles, two of which are relatively recent and discussed below.

V. Extension and Renewal Clauses

As discussed above, an overriding royalty in Louisiana is considered "an appendage to an oil and gas lease." "Expiration of a lease generally destroys an overriding royalty interest appended to the lease." "A 'washout' is the elimination of the nonoperating interest as a result of the termination or surrender of the burdened lease, and the subsequent reacquisition of a lease on the same lands by the lessee or its agent with the intention of taking the lease free from the burden of that nonoperating interest." An extension or renewal clause, also commonly referred to as an anti-washout provision, in the assignment of an overriding royalty is intended to protect the interest of the overriding royalty holder in the property. As observed in the United States Court of Appeals for the Fifth Circuit in the Avatar case:

45 §31:212.22.

46 §31:212.23. But see supra note 9.

47 Avatar Exploration, Inc. v. Chevron U.S.A., Inc., 933 F.2d 314, 319 (5th Cir. 1991) (citing §31:126)).

48 Id. (citing Fontenot v. Sun Oil Co., 243 So. 2d 783, 786 (La. 1971) and Wier v. Glassell, 44 So.2d 882, 888 (La. 1950)).


50 933 F.2d at 319. (citing Otter Oil Co. v. Exxon Co., U.S.A., 834 F.2d 531, 533 (5th Cir. 1987)).
Unhindered by an anti-washout provision, a lessee could agree with the landowner to allow a current lease to expire and to enter a new lease on the same land unburdened by the overriding royalty interest. These clauses are for the purpose of extending the overriding royalty interest to new leases obtained on the same property by the same lessee.\(^5^1\)

Since an overriding royalty cannot exist beyond the life of the tenement of title out of which it is created, the inclusion of an extension and renewal clause is vital to ensure the continued existence of the overriding royalty interest.

There are issues, however, as to how such a clause is to be applied in various factual situations. For example, how long is such a clause in force and effect? What about long periods of interruption in title? Should the clauses be applicable just for a one-year period? A ten year period? In perpetuity? When confronted with these issues the courts should look to the general rules of contract interpretation in Louisiana, as the common intent of the parties at the time of contracting should govern the contract.\(^5^2\)

Another issue is what if there is no extension and renewal clause but there has clearly been collusion between the lessor and the lessee to terminate the lease solely to eliminate the overriding royalty obligation. While there is clearly no fiduciary relationship or any implied covenant to maintain the burdened lease, there is always the concept of good faith dealing. All these aspects must be considered in determining whether the overriding royalty attaches to the “new” leases.

VI. Recent Cases in Louisiana

There are two relatively recent cases in Louisiana that address some of the issue discussed above. Both are out of the Louisiana Court of Appeal for the Third Circuit and are addressed below.


   This matter involved the enforcement of an obligation “to assign an overriding royalty.” The plaintiff, CLK, was a consulting group that generated geological drilling prospects for the oil and gas industry. It had entered into an agreement (the “Confidentiality Agreement”) with the defendant regarding a prospect in Southwest Louisiana.\(^5^3\) CLK agreed to provide geophysical and geological services to CXY in exchange for a 3.125% of 8/8ths overriding royalty interest, if CXY “acquired an

\(^{51}\) *Id.*

\(^{52}\) LA. CIV. CODE ANN. art. 2045 (2010).

\(^{53}\) 07-834 (La. App. 3 Cir. 12/19/07) 972 So.2d 1280, 1283.
interest or the right to acquire an interest in the prospect." The time period in which the interest or the right to acquire an interest had to be obtained in order for the CLK override to attach was limited to a one year period. The Confidentiality Agreement did not contain a form of assignment or any specific terms that the ultimate assignment would include.

The prospect at issue included state water bottoms and overlapping privately owned lands which made the prospect subject to very specific bidding rules with the Louisiana State Mineral Board. CXY obtained the state lease (State Lease 14367) covering the prospect but eventually released it in exchange for a state operating agreement (Operating Agreement AO206) due to mistakes made by CXY in the bidding process. Several months later, CXY released Operating Agreement AO206 and entered into another operating agreement with the state (Operating Agreement AO217) which covered the same acreage as State Lease 14367 and Operating Agreement AO206 plus an additional tract.

At trial, the parties stipulated that CLK was owed an overriding royalty interest in both State Lease 14367 and Operating Agreement AO206 and that no assignment was ever made. The defendant denied that CLK was owed an overriding royalty interest in Operating Agreement AO217 because it was obtained after the one year period provided for in the Confidentiality Agreement. The plaintiff argued that if an assignment of an overriding royalty in State Lease 14367 or Operating Agreement AO206 had been made when it was owed (within one year), such assignment would have included an extension and renewal clause. And, that the inclusion of such a clause would have made the overriding royalty interest applicable to Operating Agreement AO217 since it was an extension of State Lease 14367 and Operating Agreement AO206.

At trial, the plaintiff introduced evidence regarding the form of assignment typically utilized by the defendant in conveying overriding royalties which included a standard extension and renewal clause. The
trial court found, and the appellate court affirmed, that because the Confidentiality Agreement did not define the word “assign” or detail the terms of the assignment of the overriding royalty, it was ambiguous and therefore extrinsic evidence was admissible to show the parties’ intent.64 The court upheld the jury’s finding stating that “the evidence established that, pursuant to industry custom (as of 1992), any assignment of an overriding royalty interest would have included an extension or renewal clause.”65

Another issue in this case worth noting for purposes of this paper dealt with whether certain correspondence from the plaintiff to the defendant constituted proper written demand for payment of royalties under Article 212.21 of the Louisiana Mineral Code entitling CLK to a claim for double damages.66 The appellate court overturned the trial court and found that the correspondence at issue was a request for assignment of an overriding royalty and not a demand for payment of royalties as required under Article 212.21.67 Further, the court acknowledged that no royalties were due at the time of the correspondence as there had been no production from the prospect.68

2. Cimarex Energy Co. v. Mauboules, 6 So. 3d 399 (La. App. 3 Cir. 2009)

The Cimarex case is not an overriding royalty case, however the court considered the accrual of damages under the Articles of the Mineral Code which deal with the demand for payment of overriding royalties and therefore should be noted for the purpose of this paper. This action was a concursus proceeding instigated by the operator claiming that there was a dispute as to the entitlement to certain monies between competing interests.69 The court found that there was no valid basis for the concursus proceeding and that the operator had failed to make proper payment of royalties even though it was depositing funds into the registry of the court.70

64 Id. at 1288.
65 Id. at 1289.
66 Id. at 1290. The trial court had instructed the jury that the correspondence at issue was proper notice under 31:212.21. The jury, however, did not award double damages. Id.
67 Id. at 1291.
68 Id.
69 08-452 (La. App. 3 Cir. 3/11/09) 6 So.3d 399, 404. There was a dispute as to whether the sale of a lessor’s royalty was valid. Id. at 403.
70 Id. at 406. The trial court found that the “concursus proceeding was orchestrated as a condition to the lessor (Marboules) granting Cimarex a mineral lease, rather than as a
The appellate court affirmed the trial courts findings that: (1) the royalty owner had made proper demand for payment of royalties under Mineral Code article 212.21, (2) Cimarex had failed to pay in response to the notice of failure to pay and (3) Cimarex had failed to state a reasonable cause for failure to pay. The court upheld the award of double damages finding:

The royalties owed to Orange River are not damages but merely a sum of money due that would be owed to Orange River in any event, as Orange River is the rightful owner of those royalty interests. The Mineral Code, as cited above, plainly states that the court may award double the amount due as damages. Thus, the obligor, in addition to owing the unpaid royalties, would pay an additional sum as damages to the obligee.

As to the interest award under Article 212.23, the court found that the "date due" for damages for delayed performance is the date of written demand" instead of the date of judgment as argued by Cimarex. The court did however only award interest from the date of judicial demand because the royalty owner had not appealed such award from the trial court.

VII. Recent Cases in Other Jurisdictions

To complete this analysis there are two (2) non-Louisiana cases which should be mentioned.


This case was decided by a Texas court applying Alabama law pursuant to a choice of law clause. The issue presented was the effect of a preferential purchase right on a previously created overriding royalty covering lands within an area of mutual interest ("AMI") created by a joint operating agreement ("JOA"). In May of 2004, El Paso, notified the defendant, Geomet, that it wanted to purchase Geomet's interest in the overriding royalty covering the area subject to the preferential right. Geomet argued that while El Paso did have the right to purchase its result of actual concern about a competing claim." Id. at 404.

71 Id. at 407.
72 Id. at 407.
73 Id. at 408.
74 Id. at 408. "Further, while we did find that the interest on the statutory damages could have potentially begun to accrue from the date of judicial demand Orange River did not appeal that issue." Id.
75 228 S.W. 3d 178, 180.
76 Id.
77 Id.
leasehold interest, it did not have the right to purchase its overriding royalty. 78 El Paso then filed suit seeking specific performance of the preferential right to purchase clause. 79 The claim in question provided inter alia, that if any party desired to sell all of any part of its interests under the JOA, . . . “or its right and interest in the Contract Area, it would give notice to the other party pursuant to the preferential right clause.” 80 Geomet, the owner of the overriding royalty, refused to accept the notice from El Paso on the ground that the overriding royalty “was not part of the Contract Area” under the Farmout Agreement. 81 The court, however, found that the issue was not whether the overriding royalty “was part of the Contract Area” but was rather “whether the overriding royalty constituted a right or interest in the Contract Area.” 82 The court then found that because the overriding royalty was clearly “a right and interest in the land and leases in the Contract Area and as such, was subject to the preferential right to purchase.” 83 The lesson to be learned here is that if the parties intend the overriding royalty to not be subject to the preferential right to purchase clause, that intent should be clearly spelled out in the instrument creating the overriding royalty and/or the instrument creating the preferential right to purchase.


The court held that a release of the lease out of which an overriding royalty had been carved had the effect terminating the override. 84 The issue arose because the assignment creating the override in question provided that it would be “binding upon and shall inure to the benefit and assignor and assignee and their respective successors and assigns.” 85 In so holding the Court expressly rejected the argument that because the assignment creating the override was to be binding on assignees that it was in effect “an extension and renewal clause” and that the unilateral termination of the leases did not violate the duty of good faith and fair dealing. 86

---

78 Id.
79 Id.
80 Id. at 181.
81 Id. at 180.
82 Id. at 182. The overriding royalty in question had been carved out of oil and gas leases which covered the Contract Area. Id.
83 Id. at 182.
VIII. Conclusion

As noted at the inception of this paper, its basic purpose is to collect the existing authorities on overriding royalties and to briefly discuss the essential features of an overriding royalty. Hopefully, the paper has achieved its purpose and will provide a starting point for additional research should the need arise.