

***YOWELL V. GRANITE OPERATING ET AL—TEXAS SUPREME COURT  
PUTS PERPETUITIES IN LIMBO IN ANTI-WASHOUT CASES***

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“Perpetuities and monopolies are contrary to the genius of a free government, and shall never be allowed . . . .”<sup>1</sup> In writing that, the authors of the first Texas State Constitution enshrined the English common law Rule Against Perpetuities (the “Rule”) as the law in Texas from the near beginning.

The original rationale for the Rule is easily understandable. Allowing the English gentry to tie up most of the land in England forever in a relatively small group of families would be both dynastic and antithetical to commerce. Beyond this, however, little else about the Rule is easy to understand.

Most lawyers are exposed to the classic statement of the Rule in their first year of law school: “No interest is good unless it must vest, if at all, not later than twenty-one years after some life in being at the creation of the interest.”<sup>2</sup> Simple enough, but the Rule is notoriously rife with exceptions which have collectively bedeviled first year law students for generations. Among these are the Fertile Octogenarian Rule, the Unborn Widow Rule, the Precocious Toddler Rule, the All-or-Nothing Rule, the Wait-and-See Doctrine, and last but not least, the Cy Pres Doctrine.

If those reading this are lawyers and have not thought about the Cy Pres Doctrine since law school, or are landmen who have never heard of it, an opportunity to get either introduced or re-acquainted with the Cy Pres Doctrine has been provided by the Texas Supreme Court in its recent decision in *Yowell v. Granite Operating Co.*<sup>3</sup>

### **The Facts**

A predecessor to the defendants leased mineral rights in Wheeler County, Texas in 1986. The lease was later assigned, with reservation of an overriding royalty in the plaintiffs which included a provision saying that if the lease terminated, and the lessee obtains an “extension, renewal or new lease or leases”<sup>4</sup> covering the same mineral interest, then the reserved override would carry over. The industry term for such a provision is “anti-washout” clause.

A somewhat convoluted chain of title followed—essentially the lessee was top-leased but struck a deal with the top lessee whereby it released the old lease in exchange for an assignment of the two top leases. Production was established, but the new lessees, Granite and Apache, refused to credit the plaintiff Yowell group’s override, claiming that the Rule voided it because the period in which it could attach to new leases was indefinite.

### **The Rulings**

The trial court rendered judgment for the defendants and the plaintiffs appealed. The Amarillo Court of Appeals affirmed the trial court, concluding that the override in new leases was not certain to vest within 21 years of a life in being as required by the Rule. The Appeals Court also rejected the plaintiffs’ argument that § 5.043 of the Texas Property Code should be used to reform the assignments to avoid application of the Rule on grounds that the residual four-year statute of limitations in § 16.051 of the Texas Civil Practice and Remedies Code barred plaintiffs’ claims.

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<sup>1</sup> Tex. Const. of 1845, art. 1, § 18, carried forward still today, in article 1, § 26.

<sup>2</sup> John Chipman Gray, *The Rule Against Perpetuities* § 201 (4th ed. 1942).

<sup>3</sup> No. 18-0841, 2020 WL 2502141 (Tex. May 15, 2020).

<sup>4</sup> *Id.* at \*5.

Plaintiffs appealed to the Texas Supreme Court. Essentially the Court agreed with the Court of Civil Appeals, holding that the reservation of override created a springing executory interest to which the Rule applied. However, the Court disagreed that the four-year residual statute of limitations barred the plaintiff from seeking reformation under § 5.043 of the Property Code, and remanded the case to the Court of Appeals to determine how the statutory codification of the Cy Pres Doctrine included in § 5.043 of the Property Code could be utilized to save the reservation.

### **Cy What?**

To remind those lawyers with faded memories like mine of their first year property law class in law school, or to introduce the concept to landmen: “Cy pres means to reform as nearly as possible to accomplish the grantor’s intent.”<sup>5</sup> The doctrine is most frequently applied in construing charitable gifts, having been developed in English chancery court, it is surmised, by chancellors who were originally ecclesiastics and were motivated to save gifts made to the Church.<sup>6</sup> It later developed into a statutory provision adapted in Texas and other jurisdictions to help ensure that the intent of a grantor cannot be frustrated by application of the nearly incomprehensible body of law that had developed around the Rule Against Perpetuities.<sup>7</sup>

Practical problems in applying the Cy Pres Doctrine are legion. Property Code § 5.043 says it must be applied “within the limits of the rule against perpetuities.” What are those limits and how would they be applied in reforming a reservation of override with an anti-washout clause? Would a 21-year limit be implied? Something shorter? Would it make a difference if the new lease is taken by a stranger to the original transaction, instead of, as in *Yowell*, successors to the original lessee? Would commercial reasonableness be considered? Property Code § 5.043 states: “A court shall liberally construe and apply this provision to validate an interest to the fullest extent consistent with the creator’s intent.” What if the original creator of the interest is dead—how will his or her intent be determined? There are no reported Texas court cases providing answers to these questions.

### **Less Title Certainty, Not More; More Litigation, Not Less**

The *Yowell* case did not offer guidance on distinguishing extensions and renewals of oil and gas leases from new leases because the plaintiff conceded that the top leases were “new” leases. But the Court gratuitously said it agreed with a 10th Circuit decision, *Independent Gas & Oil Producers, Inc. v. Union Oil of Cal.*,<sup>8</sup> holding that the Rule did not apply to extensions and renewals with regard to an anti-washout clause arising in Oklahoma. Yet it does apply, said the Court, to anti-washout clauses involving new leases. Why the difference? No explanation was given.

Regardless, the Court by its ruling is encouraging prospective assignees of overriding royalties to avoid negotiating time limits in anti-washout clauses. If the anti-washout clause with no time limits applies to extensions and renewals, then the overriding royalty owner can cite *Yowell* as holding that the Rule never applies. And if a new lease is involved, the overriding royalty owner can assert not having a time limit as grounds to reform the assignment or reservation to conform to the Rule utilizing Property Code § 5.043. The result? Less title certainty, not more, and more litigation, not less.

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<sup>5</sup> Cornelius J. Moynihan & Sheldon F. Kurtz, *Introduction to the Law of Real Property*, § 11, p. 247, (3d ed. 2002).

<sup>6</sup> *Black’s Law Dictionary* 487 (11th ed. 2019).

<sup>7</sup> Moynihan & Kurtz, *supra* note 5.

<sup>8</sup> 669 F.2d 624 (10th Cir. 1982).

## The Trend Against Applying the Rule in Oil and Gas Cases

The *Yowell* case follows another recent Texas Supreme Court case, *Conoco Phillips Co. v. Koopmann*,<sup>9</sup> where the Court had also found a way around the Rule in construing a reversionary interest which becomes effective upon the expiration of a fifteen-year term non-participating royalty which could be extended by production. After a discussion of academic authorities including the *Williams and Meyers Treatise on Oil and Gas Law* at § 335, the Court decided to “exempt interests following granted or reserved defeasible term interests from the Rule, on the straight-forward basis that they serve social and commercial convenience and do not offend the policy of the Rule Against Perpetuities.”<sup>10</sup>

The oil and gas bar has had a love/hate relationship with the Rule almost since the inception of the industry. From early on, oil and gas leases themselves have been held to not violate the Rule, despite the fact that they normally have secondary terms that can last long past twenty-one years. The rationale is that oil and gas leases vest immediately upon their creation, obviating application of the Rule.

Preferential rights to purchase in Joint Operating Agreements and otherwise have likewise been held to not violate the Rule.<sup>11</sup> Top leases have gone both ways.<sup>12</sup> Areas of mutual interest (AMIs) are likewise subject to a divergence of opinion by courts and commentators as to whether the Rule applies.<sup>13</sup>

As the Williams and Meyers treatise section referred to in *Yowell* and *Koopmann* expresses it, “[t]he Rule Against Perpetuities originated and developed as a rule regulating family settlements and should not be imported into commercial transactions.”<sup>14</sup> So while not forgotten, the Rule appears to be subject to growing disfavor by courts and law professors in Texas and elsewhere.

This begs the question, should the Texas legislature prospectively enact the Uniform Statutory Rule Against Perpetuities Act, as twenty-nine other states have, whereby an interest that will otherwise violate the Rule is validated if it vests before ninety years? Or should the Rule be abolished in Texas altogether, as in a handful of other states?

## Confronting Anti-Washout Clauses Prospectively

The Texas Oil and Gas Association, in its Amicus brief to the Texas Supreme Court in *Yowell*, warned the Court against the adverse effect on title certainty that could result were the Court to rule that parties can create overriding royalty interests contingent on indeterminate expiration of prior oil and gas leases and the uncertain execution of new leases.<sup>15</sup> That, however, is at least the interim result of the Court’s remanding the *Yowell* case to the Court of Appeals to apply Texas Property Code § 5.043. Causing equal uncertainty is the Court’s ruling there is no statute of limitations on reformation under

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<sup>9</sup> 547 S.W. 3d 858 (Tex. 2018).

<sup>10</sup> *Koopmann*, 547 S.W.3d at 869 (quoting 2 *Williams & Meyers, Oil and Gas Law* § 335).

<sup>11</sup> See Bruce M. Kramer, *Modern Applications of the Rule Against Perpetuities to Oil and Gas Transactions: What the Duke of Norfolk Didn’t Tell You*, 37 Nat. Resources J. 281, pp. 300-304 (Spring 1997).

<sup>12</sup> See *Peveto v. Starkey*, 645 S.W.2d 770 (Tex. 1982) (holding a top royalty deed invalid under the Rule), contrasted with *Nantt v. Puckett Energy Co.*, 382 N.W.2d 655 (N.D. 1986) (court used both commercial and “wait and see” exceptions to uphold a top lease that would otherwise have been invalidated by the Rule).

<sup>13</sup> See *In re Ultra Petroleum Corp.*, No. 16-32202, 2018 WL 5905797 (U.S. Bankruptcy Court, S.D. Tex. Nov. 9, 2018) (Rule held not to apply to AMIs). See also Scott Lansdown, *Golden v. SM Energy Company and the Question of Whether an Area of Mutual Interest Covering Oil and Gas Rights is Binding on Successors and Assigns*, 89 N.D. L. Rev. 267, 279 (2013), for a discussion of why the Rule should apply to AMIs.

<sup>14</sup> 2 *Williams & Meyers, Oil and Gas Law*, § 335 (2020).

<sup>15</sup> Amicus Brief of Texas Oil and Gas Ass’n in Support of Respondents, *Yowell v. Granite Operating Co.*, No. 18-0841, (Jan. 8, 2020).

Property Code § 5.043. So, how many overrides thought to have been invalidated by the Rule are still lurking?

What should a title examiner do when confronted with an anti-washout clause having no time limitation when a new lease is involved? In a word—punt. Texas Natural Resources Code § 91.402(a) allows royalty payments to be withheld without interest beyond the time limits for payments otherwise set out when there is a dispute as to title that would affect distribution of proceeds. Until the Texas Supreme Court resolves the questions about applying the statutory Cy Pres doctrine found in Property Code § 5.043, title examiners should be justified in advising their oil and gas company clients they are within their rights to suspend overriding royalty payments susceptible to washout pending a stipulation of the parties or clearer guidance from the Court.

And what about landmen? Though not much can be done retroactively, in future negotiations definitions of renewals, extensions and new leases as well as time limits should be negotiated into anti-washout provisions. While the landman who was smart enough to negotiate such provisions may not see the immediate benefit, she or he can sleep better at night knowing that a title was made more certain and her or his job performed well.