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Oil and Gas Leasehold and Other Estates

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In all of the states adopting or following the common law it has been recognized that ownership of the surface carries with it everything under it or over it; and from earliest times the courts have applied this rule to solid minerals beneath the surface of the land. However, many courts have found difficulty in applying this concept to oil and gas, because of their supposedly fugacious nature. In *Ohio Oil Co. v. Indiana*, the Supreme Court of the United States stated the rule in Indiana to be:

"Although by virtue of his proprietorship the owner of the surface may bore wells for the purpose of extracting natural gas and oil, until these substances are actually reduced by him to possession, he has no title whatever to them as owner."

The trend, however, has been away from this extreme position; and today the courts of most states have adopted either the rule of absolute ownership of the minerals in place by the owner of the land, or a qualified ownership in the oil and gas beneath the land. Oklahoma and Texas, two of the largest producing states, may be used in illustrating these separate theories of ownership. The Supreme Court of Oklahoma has said that the owner of land has a qualified ownership in the oil and gas beneath it, which may be termed an exclusive right, subject to legislative control against waste, etc., to explore therefor by drilling wells and to reduce to possession and acquire absolute title thereto as personal property. This right, says the Court, is the proper subjects of sale, it may be granted or reserved, and the grantee in such a


177 U. S. 190 (1900).
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case is an "owner" of an interest in land within the meaning of the tax redemption statutes.  

Texas, on the other hand, has adopted the theory of absolute ownership of the oil and gas in place. Oil and gas underneath a tract of land constitute realty; and such minerals may be severed from the surface ownership, in legal contemplation, by a conveyance of such minerals. A deed to all "land" owned by the grantor in a specified county, for instance, would clearly convey any severed mineral estate owned by the grantor.  

It should be noted however, that a grant of the minerals or the exclusive right to produce them, is generally regarded in all states (except Louisiana) as creating some character of fee interest, but when it comes to applying this theory to leases or conveyances of royalty interests, the courts of a given state are not always consistent in the theory applied.  

Once the courts in Texas found themselves, so to speak, they have been fairly consistent. I may be pardoned for seeming to dwell too much upon the Texas decisions; but you will understand my greater familiarity with the cases from that state, and I think the development of the law in Texas on these matters is interesting and will be illustrative and helpful in other jurisdictions. In the early case of National Oil Pipe Line Co. v. Teel, the Court, dealing with an oil and gas lease which was not materially different from the commercial leases of today, held that such an instrument did not pass an interest in the land, but was a mere contract for an option by which the lessee might acquire such an interest, holding in effect that it was an executory contract, a mere franchise or equitable right; and the Court permitted the lease to be set aside for alleged fraud in its procurement, in a suit against an assignee who admittedly had no knowledge of such fraud. However, in Texas Co. v. Daugherty, the Supreme Court of Texas had before it a lease which purported to grant, sell and convey to the lessee the minerals in and under  


*Holloway Heirs v. Whatley, Sup. Ct. Tex., 131 S. W. (2) 89, 133 Tex. 608 (1939); Id v. Ellington, 131 S. W. (2) 93, 133 Tex. 615.  


95 Tex. 588, 68 S. W. 979, Sup. Ct., (1902).  

107 Tex. 226, 176 S. W. 717, LRA 1917F, 989 (1915).
the land, with royalties reserved, and a statement that it was not intended as a mere franchise; and the Court held that this particular lease did amount to a conveyance of the oil and gas in place, and that this was an interest in land, which was subject to taxation in Wichita County where the land was situated and not in the domicile of the owner. In *Grubb v. McAfee,* the Court had before it a lease which provided that upon the discovery of oil the lessee would become vested with title for a full term of 20 years. In 1903 a well was drilled and a small amount of oil produced. The lessee thereupon intentionally abandoned the project. Within the 20 year period oil was discovered in large quantities in the vicinity and the lessee then asserted title to his leasehold. The Court held that the character of base or qualified fee created by an oil lease would not survive intentional abandonment. Again in *Texas Co. v. Davis,* the lease similarly provided that upon discovery of oil or gas the lessee should continue in title for a period of 25 years and as long thereafter as oil or gas was produced. In 1902 a well was drilled and a small amount of oil produced, probably in the aggregate about 1,000 barrels. Here again within the 25 year period when the property became valuable the lessee sought to sustain his lease. It was shown that the lessee had not intentionally abandoned the project, but had been forced to do so because of lack of funds. The court, while recognizing that a lease conveyed a fee title, classified this as a base or limited fee, stating that the primary purpose of such a lease, upon the discovery of oil, was the production of it; and held that if such a lease was abandoned in fact, even though there was no intention to abandon it, the fee in the lessee would determine and revert to the lessor.

At the same time the Supreme Court of Texas was considering the *Davis* case, it decided a series of other cases which established the law in Texas on the nature of the estate created by an oil and gas lease. The case of *Stephens County v. Mid-Kansas Oil Co.,* probably the one most frequently cited, is illustrative. Here again the question arose over the right of Stephens County to tax the leasehold estates held by Mid-Kansas Oil Company on lands situated in that county. The leases did not as in the *Daugherty* case, purport to grant the minerals and did not contain any statement that the lease was not intended as a mere franchise; but the court abolished the distinction which had been supposed to exist since the time of the decision of the *Daugherty* case because of

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*109 Tex. 527, 212 SW 464 (1919).*
*113 Tex. 321, 254 SW 304 (1923).*
*113 Tex. 160; 254 S. W. 299; 29 ALR 566 (1923).*
the wording of the granting clause, and held that it made no difference in effect whether the lease purported (1) to grant the oil, gas and other minerals with the exclusive right to mine and produce the same, or (2) to grant the exclusive right to mine and take the minerals, or (3) to lease the land for the sole purpose and with the exclusive right of taking and producing the minerals therefrom. The Court quotes with approval from an early Pennsylvania case, as follows:

"What greater estate in the minerals underlying the surface of a tract of land can a man have than the right in himself, his heirs and assigns, to mine and remove the whole of it?"

Accordingly, the Court held that any oil and gas lease which gives the lessee the exclusive right to mine and produce the minerals conveys a fee estate in lands, amounting, while such leases are in effect, to a severance of the minerals and the creation of a separate estate in the lessee, which is taxable as land in the county where the land was situated. The Teel case was squarely overruled.

This doctrine, that a mineral lease creates a limited or determinable fee, established in 1923, has been consistently followed and applied in Texas since that date.

As might be expected, the Oklahoma courts hold that an oil and gas lease does not vest in the lessee the title to the oil and gas in the land and is not a grant of any estate therein, but is simply a grant of the right to prospect for oil and gas, no title vesting until such substances are reduced to possession by extracting same from the earth,—an incorporeal hereditament.¹¹

The Supreme Court of Wyoming in Boatman v. Andre," speaking of the nature of the interest created by an oil and gas lease, said:

"While it is settled that the title to the land cannot be lost by abandonment, * * * it is equally well established that the interest of a lessee under the ordinary form of oil and gas lease presents a right of a different character. The right created by the lease, is merely to search for oil and gas, and, if either is found to remove it from the land leased. This would appear to make it a profit a prendre * * *, and hence an incorporeal hereditament, which may be lost by abandonment."¹²

¹²12 Pac. (2) 370 (1932).
¹³See also Joint Stock Land Bank of Denver v. Dixon, Sup. Ct. Wyo., (1942), 122 Pac. (2) 842, 140 ALR 1270, where Boatman v. Andre was cited with approval.
The Supreme Court of Colorado in *Lanham v. Jones*, apparently adopted the option theory of oil leases, citing *National Oil Pipe Line Co. v. Teel* (even though that case had in effect been overruled by the Supreme Court of Texas prior to the date of the Colorado decision). The more recent decision by the Supreme Court of Colorado, *Mountain States Oil Corp. v. Sandoval*, involving an attempt to cancel an oil lease for breach of implied covenant of development, sheds little additional light on the theory of the Colorado courts in regard to the nature of the estate created by an oil lease.

The one case to which I have been cited in Utah, *Meagher v. Unitah Gas Co.*, dealt with a very unusual situation and a special form of lease agreement. The specific holding of the case was that there was no abandonment of a lease merely by moving off the rig, if the specific obligations of drilling had been complied with and there had been no violation of any express provision on which a termination of the lease might be founded, particularly since no notice of termination was given prior to filing suit. The Court might have used this case as an opportunity for declaring some general principles for the guidance of oil operators and attorneys in Utah, even though somewhat beyond the scope of what the Court was actually called on to decide.

In Montana the Court has adopted the theory of complete ownership of the minerals in place, including oil and gas, *Gas Products Co. v. Rankin*, in which case the Court held unconstitutional a statute prohibiting the use of gas for the making of carbon black. The Court announced the law in Montana (contrary to that stated by the Supreme Court of the United States in *Ohio Oil Co. v. Indiana*, to be the law in Indiana):

"Both petroleum and gas, so long as they remain in the ground, are part of the realty. They belong to the owner of the land, and are a part of it so long as they are in it, or subject to his control."

There, however, the analogy with Texas apparently ceases. In *Rist v. Toole County*, the Court quotes with approval language used in the opinion of *Homestake Exploration Co. v. Schoregge*, as follows:

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1 Supra.  
2 268 Pac. 521 (1928).  
3 105 Mont. 604, 264 Pac. 388.  
4 Supra.  
5 159 Pac. (2) 340 (1945).  
6 1268 Pac. 993, 24 ALR 204 (1922).  
7 185 Pac. (2) 747 (1947).  
8 207 Pac. 993, 24 ALR 204 (1922).  
9 Supra.  
10 1268 Pac. 993, 24 ALR 204 (1922).
"The owner of the fee has the same title to the oil and gas in place which characterizes the ownership of solid minerals in like circumstances, but by his lease, regardless of the form of the granting clause, he does not intend to convey the oil and gas in place or any interest therein. * * * By a lease of this description the lessee is vested with a present property right in the leased premises, namely, to search for oil and gas under the conditions of the lease and to appropriate them as personal property if found, yielding the stipulated royalty. This is a right to take a profit from the lands of another and within the common law classification may be regarded as a profit a prendre."


In fact, doubt is cast on the ownership theory in Montana by the holding of the Supreme Court in 1938 in *Toomey v. State Board of Land Commissioners*, where the Court speaks of the "migratory character of gas," and says: "There is no actual ownership of gas in situ." (Citing as authority, strange to say, *Gas Products Co. v. Rankin*, supra).

Perhaps in view of the recent decisions of the Supreme Court in the so-called Tidelands Cases, where the Court expressly declined to hold that the United States had title to submerged areas off the coast of these states, but held that the Federal Government had "paramount rights" therein, with full dominion over the oil thereunder, the distinctions in the different theories regarding the estate of an oil and gas lessee are not as important as we had supposed. As to the lease itself, however, the two theories of ownership and estate created have resulted in different rules. In Texas since the payment of the rental was a limitation on the grant, it as early held that a court of equity was powerless to relieve against a failure to pay the rental within the prescribed time due to mistake or accident. The same policy prevails in other states which have adopted the Texas theory, and apparently in Montana."

106 Mont. 547, 81 P. 2d 407.
White v. Hunt, 10 So. (2) 539, Sup. Ct. Miss., (1942); Hughes v. Franklin, 29 So. (2) 79, Sup. Ct. Miss., (1947); McDaniel v. Hager-Stevenson Oil Co. (Mont.) 243, P. 582; Griffin v. Cedar Creek Oil & Gas Co.
It should be noted, however, that the Texas courts have been equally careful in protecting the lessee under the protective clauses contained in most leases in regard to assignments or conveyances carrying an interest in the rentals.\footnote{It has been applied even in cases where the property was homestead.}

Notwithstanding that the failure to pay rental has been stated by the Texas courts to be an absolute limitations on the grant covered by an oil lease, later decisions have shown a tendency to modify this rule to the extent of granting relief in equitable situations under theories of waiver, revival and estoppel. In *Humble v. Clark*,\footnote{where the grantee in a mineral deed was somewhat ambiguous as to the interest conveyed in the land subject to an existing lease, waited until after the rental paying date and then advised the lessee oil company that he refused to accept rentals which had been deposited with his knowledge in the depository bank, because the amount was insufficient, such assignee was estopped to claim that the proper amount had not been paid. The Court relies somewhat on the provision in the lease that “no change in ownership shall impose any additional burdens on the lessee.” Again in *Mitchell v. Simms*, the Supreme Court of Texas held that where the lessor voluntarily accepted late payment of rentals that amounted to a ratification or revival of the lease.}

In *Humble v. Clark*,\footnote{Humble v. Clark} the Court holds that a mineral deed executed by the landowner in which reference was made to the lease as a subsisting lease, operated as a revival of such lease even though it had theretofore expired according to its terms for failure to pay rental; and the same rule was applied in the Federal Court for the Fifth Circuit where the original lease was void because of defective description.\footnote{The Supreme Court of Texas in *Waggoner v. Sigler*, while fully adopting the rule in regard to implied obligation of reasonable development, \footnote{The Court further holds, (Mont.) 8 P. (2) 1071; cf. Consolidated Gas Co. v. Reickhoff (Mont.) 151 P. (2) 588.} holds that breach of such implied covenants will not authorize forfeiture of a lease, as for breach of condition subsequent, since it is a mere covenant. The Court further holds,}

It has been applied even in cases where the property was homestead.\footnote{Cassity v. Smith, 193 S. W. (2) 991; Benson v. Lacey, 202 S. W. (2) 689. See also Brandt v. Roxana, 29 Fed. (2) 980.} Again in *Humble v. Harrison*,\footnote{126 Tex. 262, 87 S. W. (2) 471.} where the grantee in a mineral deed which was somewhat ambiguous as to the interest conveyed in the land subject to an existing lease, waited until after the rental paying date and then advised the lessee oil company that he refused to accept rentals which had been deposited with his knowledge in the depository bank, because the amount was insufficient, such assignee was estopped to claim that the proper amount had not been paid. The Court relies somewhat on the provision in the lease that “no change in ownership shall impose any additional burdens on the lessee.” Again in *Mitchell v. Simms*,\footnote{Greene v. White, 153 S. W. (2) 575, 156 ALR 526; Grissom v. Anderson, 79 S. W. (2) 619; Reserve Petroleum Co. v. Hodge, 213 S. W. (2) 456.} the Supreme Court of Texas held that where the lessor voluntarily accepted late payment of rentals that amounted to a ratification or revival of the lease.

The Supreme Court of Texas in *Waggoner v. Sigler*,\footnote{Greene v. White, 153 S. W. (2) 575, 156 ALR 526; Grissom v. Anderson, 79 S. W. (2) 619; Reserve Petroleum Co. v. Hodge, 213 S. W. (2) 456.} while fully adopting the rule in regard to implied obligation of reasonable development,\footnote{Sup. Ct., Tex., 146 Tex. 146 Tex. 216, 205 S. W. (2) 555, (1947).} holds that breach of such implied covenants will not authorize forfeiture of a lease, as for breach of condition subsequent, since it is a mere covenant. The Court further holds,
however, that where there is no adequate remedy at law a court of equity is not powerless to do justice and that it may entertain an action to cancel the lease in whole or in part. This equitable action for cancellation of a lease has been recognized where there are extraordinary circumstances and no other adequate remedy. The rule was first announced in the case of Kleppner v. Lemon; and later elaborated on in the well known Kansas case, Brewster v. Lanyon Zinc Co. It has been applied in a number of cases; but in a number of other cases cancellation has been denied.

In those states which have adopted the qualified theory of ownership of mineral or which hold that an oil lease passes only a franchise or privilege, no difficulty whatever should be encountered in securing cancellation in whole or in part of a lease because of breach of implied covenant of development, under this type of decree. The courts universally hold that they will not order the doing of an act which would require supervision on the part of the Court, such as the drilling of a well; but under the theory of the cases I have just referred to, a decree of an alternative nature is entered,—the lessee is required to drill certain wells to specified depths or producing sands within a given time, or the lease, or that part of the lease in question, will be cancelled. Actually this seems to have been what was done in the recent Colorado case of Mountain States Oil Corp. v. Sandoval. In the opinion it is stated that the decree of the trial court cancelled all the leases and appointed a receiver; but that the judgment provided that if the lessee in good faith resumed drilling operations on the premises within 90 days from the date of judgment, the same would be vacated, and that the court retained jurisdiction for that purpose. The higher court, after pointing out that this permission for further development within 90 days after judgment was not exercised by the lessee, stated that it was of the opinion that cancellation was warranted by the evidence, as to those portions of the leased premises not related to or affected by four wells which had been drilled. This holding, the Court said, “is in harmony with equity and good conscience.’

48 Atl. 483 (Pa.).
140 Fed. 801.
Scott v. Jackson, 37 S. W. (2) 1068; Carter Oil Co. v. Mitchell, 100 Fed. (2) 945; Cosden v. Scarborough, 55 Fed. (2) 634; Sauder v. Mid-Contin-ent, 292 U. S. 272; Amerada v. Doering, 93 Fed. (2) 540; Rendleman v. Bartlett, 21 S. W. (2) 58; Severson v. Barstow, 63 P. (2) 1022 (Mont.).
Supra.
The other important type of mineral interest or estate which must have consideration is the royalty interest. The process of judicial determination of the character of this interest in Texas moved along very similar lines to that followed in determining the nature of the estate created by an oil lease. The first case of major importance in Texas was Hager v. Stakes. There the tax collector of Orange County assessed for taxation as real property certain royalty interests owned by Lee Hager, a resident of Houston. He contended that the obligation to pay royalties, particularly those arising under leases, was in the nature of a covenant, a contract right, which was personalty and could only be taxed in the county of his residence. The Supreme Court carefully analyzed the granting clause in the lease in each instance and held that where the lessor had reserved a part of the oil and gas produced which was to be delivered to him in kind (even though in one case the lessee reserved the right to buy the royalty oil as produced), he had in effect retained title to that part and until it was produced it remained a part of the realty and constituted land situated in Orange County. The Court indicated, however, that where the lessee obligated himself merely to pay lessor the value of $\frac{1}{8}$ of the oil and gas produced, the lessor’s interest was merely a contractual obligation and therefore personal property. It should be borne in mind that at the time this case arose the Supreme Court, in Stephens County v. Mid-Kansas, had held that a lease vested title in the lessee to the minerals in the land, although the extent of the mineral estate was not before the Court. So in Haker v. Stakes, the Court made it clear that except in one type of lease, only $\frac{7}{8}$ths of the minerals vested in the lessee under an oil lease, the other $\frac{1}{8}$ remaining in the lessor.

This was the situation until the case of Sheffield v. Hogg was decided. There the Court wiped out the rather artificial distinction it had made in the case of Hager v. Stakes, dependent on the wording of the royalty provision in the lease or in the grant; and held that whether the royalty was deliverable in kind as produced or the lessee was merely to pay the value of it as produced or had the option to purchase it and pay the value thereof, the lessor in an oil lease had in effect reserved $\frac{1}{8}$ of the oil in place, which the lessee was obligated to produce, without cost to the lessor, along with the lessee’s $\frac{7}{8}$ part of the oil. In the course of its opinion, the Court says:

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*a*116 Tex. 543, 294 S. W. 835 (1927).
*Supra.*
*a*124 Tex. 290, 80 S. W. (2) 741.
"The oil industry in Texas is largely dependent for development, growth, or prosperity, on the doctrine that the interests we are considering—such as the lessee’s and the lessor’s estates under contracts which are in customary use in Texas—are interests in land; and hence not subject to parol sale, but have the protection of the statute of frauds, the statutes regulating conveyances and mortgages of real estate, and the statutes requiring the recording of instruments affecting title to or liens on land, so that purchasers can rely on deed and lien records and can execute and receive transfers and conveyances in reliance on true abstracts of title and lawyers’ correct opinions thereon. Were the stability furnished by these rules withdrawn and the fundamental contracts, on which the oil business so largely rests, be adjudged by the Supreme Court to create mere rights in personalty at some uncertain date in the future, the structure of the business would be seriously, if not fatally, jeopardized."

Accordingly, the various royalty interests owned by Hogg Brothers in Brazoria County were held to be taxable there as real property, notwithstanding the residence of the Hoggs was in Houston. The Supreme Court of the United States has confirmed this ruling as applied to lands in Texas, *Waggoner Estate v. Wichita County*.

In *Sheffield v. Hogg*, the Court did not specifically say that the lessor in an oil lease actually retained title to 1/8 of the oil and gas in place; but the specific holding was that a royalty interest constituted an "interest in lands" which was taxable in the county where the land was situated, under the Constitution of the State of Texas. This same rule has been applied to so-called oil and gas payments. In *State v. Quintana Petroleum Co.*, the Court had before it a reservation of 7/32 of the oil and gas, in an assignment and sale of leases, to be delivered to the assignor free of cost of operations, until the proceeds amounted to $2,000.00. The Court held that this was an interest in land taxable as such in the county where the land was situated and that it should be valued at its present worth with a decreasing value each year as amounts were applied to the oil payment.

In those states which maintain the qualified theory of ownership of minerals by the landowner, it would seem logical that they would apply to various types of royalty interests much the same theory that they apply to leases: that it is a right, appurtenant to the land, but not a fee interest, and that conveyances of

\[273 \text{ U. S. 113.} \]

\[134 \text{ Tex. 179, 133 S. W. (2) 112.}\]
royalty interests do not convey any part of the land itself. In Denver Joint Stock Land Bank v. Dixon, the Supreme Court of Wyoming held such an interest to be an incorporeal hereditament, a profit a prendre, a right appurtenant to land,—not personalty. If the landowner has only a qualified ownership of the minerals in place prior to executing an oil lease, then, of course, he would have no greater interest in the oil in place by virtue of his retained royalty interest. In Rist v. Toole County, the document was called "assignment of royalty" and purported to assign an undivided 5½% royalty of and in all of the oil, gas and other minerals produced and saved from certain land. It recited "and I do hereby assign said royalty under the lease now covering said lands as well as any lease or leases that may be hereafter made covering said premises." The Court held that this was not a severed interest in the fee and was therefore not separately taxable. The Court quotes from Glassmire's Oil and Gas Leases and Royalties, 2d ed., wherein he says:

"It was recognized that simple assignments of royalty proper, accruing under a lease, conveyed nothing except proceeds when and as obtained, or purely personal property interests.

A conveyance or assignment of royalty for a definite or indefinite term of years does not anywhere constitute a grant of minerals, and no severance from the land is consummated under them. Even in Texas, an ownership State, it has been held that an assignment of rents and royalties accruing under an existing lease amounts merely to a transfer of personal property and is not such a conveyance of lands as to bring it within the statute of frauds."

Mr. Glassmire was referring to the Texas case of Caruthers v. Leonard. Actually the holding in that case was that a conveyance of minerals subject to an existing lease passed no title to the rentals under the lease; but in the past it was thought that some language in the opinion justified the application of the rule also to royalties. The case was subject to much criticism and fortunately was squarely overruled by the Supreme Court of Texas in December of 1943, in the case of Harris v. Currie. This was well over a year before the Supreme Court of Montana

"122 Pac. (2) 842 (1942).
"Supra.
"159 Pac. (2) 343-4.
"254 S. W. 779.
"176 S. W. (2) 302.
decided the case of *Rist v. Toole County*; and in my view, Justice Angstman's position in his dissenting opinion, that a royalty interest is a separate interest in land (relying in part on the leading Texas cases), is the more logical one. Since Montana has the theory of absolute ownership, it of course, recognizes the right of the owner to convey a part of the minerals in place and to vest fee simple title thereto; but apparently a pure royalty conveyance in Montana is not a severed interest in the fee, but some kind of lesser interest or estate. It has been suggested by some Montana lawyers that this case of *Rist v. Toole County* should have been disposed of by simply saying that the Montana Constitution does not provide for taxation of interests of this character. In *Marias River Syndicate v. Big West Oil Co.*, the Supreme Court of Montana said that the word "royalty" has a well understood meaning in oil operations; that this right belonging to one distinct from the owner of the land, is an interest in land, which may be conveyed or excepted. It is, the Court says, an incorporeal interest, which may be regarded as a *profit a prendre*. I cannot pass this case without saying that in my opinion it has created a rather difficult problem for the lawyers of Montana in the construction of so-called royalty conveyances. The language in the deed in that case was:

"Reserving * * * a 12½ per cent interest and royalty in and to all oil and gas or other minerals of whatsoever nature found in or located upon or under said land * * *, or that may be produced therefrom."

The Court held that this amounted to an exception of 12½% of the minerals in place, which however, would be subject to its pro rata share of the cost of extraction and marketing. The Court laid great stress on the fact that the reservation was of minerals in and under the land. It is submitted, however, that in view of the fact that it was called a "royalty" and that the interest was in that to be produced from the land, the Court should have held that it was a royalty interest as that term is commonly understood.

We have had some interesting cases on this point in Texas. In *Schlitter v. Smith*, the grantor in a deed reserved "one-half interest in and to the royalty rights on all of the oil, gas and other minerals in, on or under, or that may be produced from the land herein conveyed." The trial court held that this reserved one-half of the usual 1/8 royalty; the intermediate appellate court held that it was a reservation of a full 1/2 interest in the minerals.

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*38 Pac. (2) 599 (1934).*
*101 S. W. (2) 543, 123 Tex. 628.*
in place, saying that it was only by such a reservation that the grantor could realize $\frac{1}{2}$ of the "royalty rights"; but the Supreme Court held that the reservation was only of a royalty, without any interest in leasing rights or in bonuses and rentals, and that it necessarily implied that the grantee had full power to execute oil and gas leases and that what was reserved was simply $\frac{1}{2}$ of whatever royalty the grantee might thereafter retain in leases which he executed whether $\frac{1}{3}$ or more or less. Another interesting case is Tipps v. Bodine,\textsuperscript{a} where one of the Texas courts did a masterful job of reconciling apparently conflicting portions of a mineral and royalty deed and arriving at what was, I think, the real intention of the parties. In Watkins v. Slaughter,\textsuperscript{a} a recent decision by the Supreme Court of Texas, the land was conveyed by deed, together with a 15/16 interest in the minerals, the grantor retaining title to 1/16 of the minerals. It was specified that the grantee was to have all bonuses, rentals and leasing rights, the "grantor to receive the royalty herein retained only from actual production." The Court held that this reservation was a 1/16 royalty interest. The Court based its decision on the grounds that since the grantee was to receive all bonuses and rentals and had exclusive leasing rights, he had all of the incidents of ownership of the minerals in fee; and that since the grantor was to receive his 1/16 share "only from actual production" and since it was called "a royalty," it as evidently intended by the parties that his interest should be a royalty interest, a term which had a well defined legal meaning. I submit that where an interest is called a royalty interest, this in itself should be sufficient for the courts of all states to construe the document as passing title to or reserving exactly that. Any rule of construction which disregards the well established legal meaning of the term royalty and the common acceptance of that term by every oil man, is not arriving at the true intent of the parties and is bringing on untold trouble for lawyers and royalty buyers.

The greatest difficulty in this respect arises in connection with the so-called "mineral and royalty conveyances," where a fixed interest in the minerals is conveyed, but, the property being under an existing lease, the instrument also purports to cover a stated share of the royalties under such lease, and perhaps to specify the relative interests of the parties in the future. These

\textsuperscript{a}101 S. W. (2) 1076.
\textsuperscript{a}189 S. W. (2) 699.
forms have caused infinite confusion which, of course, would be entirely avoided if the same fraction was used throughout. 33

One of the cases which has plagued the Texas lawyers over the years is Hoffman v. Magnolia Petroleum Co. 34 An oil and gas lease in usual form had been executed covering 320 acres out of a section of land in Comanche County. Thereafter the lessors executed to the plaintiff a conveyance of 1/2 of the oil, gas and other minerals in and under a specific 90 acres of land out of the 320 acres covered by the lease. The instrument then continued with the usual "subject to" clause, referring to the lease outstanding, and went on:

"It is understood and agreed that this sale is made subject to said lease but covers and includes 1/2 of all of the oil royalty and gas rental or royalty due to be paid under the terms of said lease. It is agreed and understood that * * * * in the event that the above described lease for any reason becomes cancelled or forfeited, then and in that event the lease interest and all future rentals on said land for gas and mineral privilege shall be owned jointly by James N. Duke and wife and * * * Hoffman, each owning 1/2 interest in all oil, gas and other minerals in and upon said land, together with 1/2 interest in all future rents."

The court, applying the rule that ambiguous deeds should be construed most strongly against the grantor held that the deed actually conveyed two separate interests in land: (1) an undivided 1/2 interest in the possibility of reverter of the oil and gas in place under the 90 acres, and (2) an undivided 1/2 interest in the royalties under the existing lease on the entire 320 acre tract. The court defends this construction by saying that it was undoubtedly arriving at the intention of the parties; but here again I submit that no lawyer or oil man in Texas, familiar with practices in the oil business, would ever have given the instrument that construction. The grant of the royalties was not a separate grant. It was probably unnecessary in the first place; but it was thrown in purely in explanation of the intention and effect of the conveyance of the 1/2 of the minerals in the 90 acres; and the Court should have held the instrument in its entirety applicable only to the specific 90 acres described. In a conveyance of an undivided part of the minerals in place, it is, of course, essential that some reference be made to outstanding leases,

33See again in this connection Tipps v. Bodine, supra, and also Evans v. Mills, 67 Fed. (2) 840, Cates v. Green, 114 S. W. (2) 592.
34273 S. W. 828 (Tex. Comm. App., 1925); see also Grelling v. Allen, 218 SW (2) 896.
OIL AND GAS LEASEHOLDS

otherwise the general warranty contained in such instruments would be breached immediately; but as a result of the Hoffman case, it is now customary to add language which would read, as applied to that case, in connection with the royalty paragraph, "as to, but only as to the 90 acres hereinabove specifically described."

Similar questions may arise in conveyances of mineral and royalty interests in view of the prevalence of pooling provisions in modern day leases, particularly as applied to gas wells where under modern conservation statutes large acreage production units are required.64

Mr. Summers states the rule in Oklahoma as to royalty interests to be that a grant or reservation of a royalty interest, whether before or after lease, includes a proportionate interest in the right to produce the minerals, and a grant or reservation of the minerals, subject to an existing lease, grants or reserves a proportionate share of the royalties under existing or future leases.

In this connection, I would like to quote from the excellent article by Mr. Masterson, in a recent issue of the Southwestern Law Journal,65 where he is speaking of the interest created by a typical oil and gas lease:

"Under the qualified ownership theory, it is impossible to vest a fee title by execution of an oil and gas lease. This immediately poses the problem whether in such states the interest should be treated as realty or as per-


It is interesting to note the part that ad valorem taxation has played in bringing up cases which require the courts to pass on the nature of mineral, leasehold and royalty interests. My attention has been called to the recent case of Mitchell v. Espinosa, 243 Pac. (2) 412, by the Supreme Court of Colorado. It was there held that a reservation of "one half of oil rights" in a deed to land accomplished a severance of one-half of the oil estate—A freehold estate, which would not pass under tax sale based upon assessment of the land (against the owner of the surface and the other one-half in the minerals). Likewise, the Montana case of Rist v. Toole County involved the question of whether a pure royalty interest was subject to taxation as real property. Both Montana and Wyoming have statutes for taxing producing leases and royalty interests on net proceeds of production, but apparently in neither state are non-producing lease and royalty interests subject to taxation.

sonalty. This in turn will determine, among other matters, whether the Statute of Frauds is applicable, whether the registration statutes apply, whether the interest is taxable as realty, and whether the interest can be lost by abandonment. The cases are in much confusion as to whether the interest is realty or personalty. It is clear that because of the large amounts frequently involved in transactions in this field, justice is best served by treating the interest as realty. This factor, when added to the consideration that actually an oil and gas lease does vest a present interest in land (even assuming the premise that there can not be actual title to oil and gas until discovery), has resulted in a definite trend in favor of treating the interest as one in realty."

It is submitted that this trend is sound and that it should be applied to royalty interests of different character as well. Whatever basic theory of ownership is applied, however, I believe the lawyers should urge upon the courts in the newer oil and gas producing states, as their jurisprudence is being developed, that they constantly keep in mind the practical, every day meaning attributed to such terms as "royalties" in the oil and gas business, and that they seek to construe conveyances of oil and gas interests and royalties in the light of these meanings. Any other approach must lead to uncertainty among lawyers when an instrument is submitted for construction and to a body of decisions by the court of the ad hoc variety which have little value as precedents and lead to confusion.\(^5\) Some instruments will undoubtedly come up for construction which are so ambiguous that their actual meaning cannot be settled except by court decision; but much litigation will be avoided if the courts do recognize these well recognized meanings attributed to words in the oil industry and give them practical application in every case except where other portions of the instrument show beyond question that some different meaning was intended.

Likewise, until general policies of construction are announced by the courts of any state, the lawyers must go to greater lengths in identifying the character of interest intended to be reserved or conveyed by a given instrument. If a mineral fee is intended, a reference might appropriately be made to corresponding rights of ingress and egress and possession of the surface for development and producing; whereas if a pure royalty interest is intended, it would be appropriate not only to call it a "royalty".

\(^5\)Surrounding Facts and Circumstances in the Construction of Legal Instruments, VIII Tex. Law Rev. 401 (by the author of this article).
but also to specify that the interest would be delivered free of all costs of development and operation as produced and saved.

Perhaps I should point out that even in states such as Texas having the absolute ownership theory, it is now settled that any statutory or regulatory provision which bears a reasonable relationship either to conservation of these natural resources or to the adjustment of correlative rights of the owners of property in a field, or both, is valid. Such orders, of course, must afford each owner a fair opportunity to produce from the common pool an amount of oil or gas approximating that which underlay his land prior to regulation, or alternatively, to receive payment based upon such amount.55

Perhaps it would also be interesting to note, in conclusion, that little has been added to the jurisprudence on the subject of protection of correlative rights of owners in a common pool to what was said by the Supreme Court of the United States in 1900 in Ohio Oil Co. v. Indiana.56 In the petition in that case, which was brought in an effort to prevent the waste of gas in connection with producing oil in Indiana, the Attorney General of Indiana alleged that natural gas was the cheapest and most effective fuel that had yet been found. The vast production of oil from the East Texas Field compelled a modification of the rule of capture by a recognition of the necessity of protecting correlative rights of owners in a common pool; and the tremendous increase in the use of gas in the past 50 years, with the consequent increase in its value, has made it easier for the courts to justify and sustain regulatory statutes, both for the protection of private property rights and for the preservation and conservation of these great natural resources.57


56177 U. S. 190.

57See Legal History of Conservation of Oil and Gas, Section of Mineral Law, American Bar Association (two volumes, one published in 1938 and the other in 1948).
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