Denver Law Review

Volume 29 | Issue 5 Article 7

June 2021

Creating Mineral and Royalty Interests

John H. Tippit

CREATING MINERAL AND ROYALTY INTERESTS

JOHN H. TIPPIT
of the Denver Bar

The major oil and gas interests may be classified as the mineral fee estate, the royalty interest and the leasehold estate. Their nature as well as the fundamental distinction between a mineral interest and a royalty interest must be understood before any proper concept can be had of oil and gas law. This article is concerned with the method of creating mineral and royalty interests and with certain errors in draftsmanship which are easily avoided, but which commonly occur, and result in much confusion and litigation.

Mineral interests are created by reservation and exception or by deed. If a mineral interest is intended, the wording should be such that it conveys the fee estate of the owner, including the right to lease, receive bonus, delay rentals and royalties as well as the reversionary right to the minerals if the land is already under lease. The granting clause should not be limited, for instance, to such phrases as "one-half of the oil and gas that may be produced." Such phrases make the interest contingent upon production, whereas ownership of a mineral interest is not. The grant should be "one-half of the oil and gas in, under and that may be produced."

In drafting conveyances, the right of ingress and egress should be considered. The right of ingress and egress is implied in a reservation but in a conveyance, no such right is implied. These rules have been applied to mineral reservations and deeds by the Oklahoma Supreme Court.

The creation of a royalty interest is much more difficult and has led to confusion as to the type of interest which was intended by the parties. This is understandable when it is considered that a royalty interest may be:

1. Limited to existing or future leases only.
2. Created before or after lease.
3. Participating (as to delay rentals and bonus) or non-participating, and
4. With or without a reversionary estate in the mineral fee.

The question of whether the interest is created before or after lease is of paramount importance and the draftsman should carefully consider this fact. If before lease is issued, then it may be anticipated that an oil and gas lease executed later will provide for the usual 1/8th royalty. What would be simpler, as a method of creating a 1/2 interest in royalty, than to convey 1/2 of the 1/8th oil and gas royalty or, as merely another way of stating it, $\frac{1}{16}$th of the oil and gas in said lands?

I am told that this thought occurred to the attorney of an Oklahoma oil company which owned many tracts of land in fee. It decided to sell the surface and one-half of the royalty, retaining to itself the right to drill and develop, i. e., the mineral interest. The attorney prepared deeds conveying the fee and reserving to the company $\frac{15}{16}$ths of the minerals.[1] The purchaser would receive $\frac{1}{16}$th of the minerals which, the attorney reasoned, was ½ of the usual ⅛th royalty. The effect of the instrument, however, was to convey a $\frac{1}{16}$th *mineral interest* to the purchaser rather than one-half of the royalty and the company was compelled to purchase from its grantees an oil and gas lease covering the outstanding $\frac{1}{16}$th mineral interest before the company could drill.

The purchaser was not well off either. He thought that he would get ½ of the royalties and instead received a $\frac{1}{16}$ mineral interest from which he was entitled to receive ⅛th of the production. He gets, therefore, ⅛th of $\frac{1}{16}$th, or 1/128th of the total production instead of ½ of the usual ⅛th royalty.

The Oklahoma Supreme Court has commented on this confusing situation by noting that some lawyers and most laymen thought that in order to reserve ½ of the royalty rights, it was proper to reserve $\frac{1}{16}$th of the oil and gas.

There have been many cases also on the interpretation of reservations such as:

½ of royalty
½ of the landowners' royalty
½ of the oil and gas that may be produced
½ of oil and gas that may be found

All of these imply a royalty interest as distinguished from a mineral interest. The grantor usually contends at a later date that he intended to reserve the right to execute oil and gas leases and to receive bonus and delay rentals. In states which do not follow the West Virginia rule, he would have reserved a right to receive ½ of the royalty only and a full interest oil and gas lease could be obtained from his grantee.

Not only is the wording difficult in royalty conveyances prior to lease, but the factual situation also offers some trouble. For instance, before a lease is executed, you may desire to reserve ½ of the usual 12½% royalty in the following language:

> "Reserving to grantor 6¼% of the royalty payable under oil and gas leases which may be executed in the future covering said lands."

These troublesome situations may result:

1. The mineral interest owner may execute a lease for a 20 per cent royalty and, instead of getting ½ of the royalty, your client is getting about ⅓rd.

[1] "Reserving to grantor, its successors and assigns, an undivided 15/16 interest in all the oil and gas and other minerals in and under said lands."

2. The mineral interest owner may refuse to execute oil and gas leases in the future.

3. The mineral interest owner may decide to drill a well himself and no lease is executed. Your royalty is stated to be under future leases only.

With relation to the first problem, your client's interest of 6¼% will not be enlarged unless there is latent ambiguity in the conveyance by which the Court could reform the instrument to the intent of the parties. With reference to forcing the mineral interest owner to lease in the future, a possible violation of the rule against perpetuities may be involved. With reference to the third problem, the better view is to the effect that the royalty interest, on the basis of the usual ⅛th, should be honored by the mineral interest owner if he, as owner, develops the property himself.

Most instruments such as these are construed by the courts in the light of the intention of the parties. However, such intention is obscure when, by a grant of $\frac{1}{16}$th of the minerals, one party meant ½ and the other meant 1/124th of the royalties. The creation of a royalty interest prior to lease demands both thought and skill in adapting the grant or reservation to the intention of your client. There is danger that it may violate the rule against perpetuities. In such instance, the use of a mineral deed, with various rights of participation eliminated, is suggested.

CONVEYANCES OR RESERVATIONS AFTER LEASE

After the lease has been executed, there are merged in the landowner three mineral estates:

a. the ownership of the mineral fee subject to the lease;

b. the right to receive rents and royalties under the oil and gas lease;

c. the right to receive the remainder of the mineral estate on the termination of the oil and gas lease.

A well drafted mineral conveyance after lease should convey all three rights which might be done as follows:

(a) A hereby grants an undivided ½ interest in all the oil and gas in, under and that may be produced from said lands.

(b) Grantee shall receive ½ of all bonuses, rents, royalties and other proceeds which may be paid under the terms of the oil and gas lease above described.

(c) In the event said oil and gas lease becomes cancelled or forfeited, grantee shall own an undivided ½ interest in all the oil, gas, etc.

The grantee in such an instrument is not required to obtain from his grantor a separate assignment of the lease benefits in order to receive rents and royalties. (Some attorneys in Northeastern Colorado unnecessarily follow the practice of conveying

lease benefits by a separate instrument after a conveyance of the fee has been made.) The grantee should deliver a photostatic copy of his conveyance to the lessee in order to place the lessee on notice of his interest.

The lease form usually designates a bank where rentals may be paid and if a change is desired, request should be made on change of depository forms which may be obtained from the lessee.

PITFALLS IN TRANSFERRING INTERESTS AFTER LEASE

1. With reference to the interest conveyed by the granting clause, do not adapt it to the thought that the entire interest presently owned by the landowner is a 1/8th interest. The Montana cases of *Hochsprung v. Stevenson*,[2] *Krutzfeld v. Stevenson*,[3] and *Broderick v. Stevenson Consolidated Oil Co.*,[4] involve the following language:

(a) "hereby grants a 5% interest in and to all the oil and gas that may be produced.

(b) "includes 2/5ths of rents and royalties payable under existing lease.

(c) Grantee shall have 2/5ths of oil and gas upon termination of lease.

In the Hochsprung case, the Court refused to take into consideration all the different parts (a, b and c) of the conveyance and held that under the first clause, 5% of the oil and gas had been conveyed to the grantee and that upon the expiration of the lease, there being no words of grant in the last clause, the grantor would still own 5% of the oil and gas, rather than 40% or 2/5ths. In other cases, the same wording has been shown with the exception that fractions are used. For instance, a $\frac{1}{16}$th interest in all oil and gas is conveyed and such grant is connected with an intention that the grantee shall receive 1/2 of the royalties.

The Montana Supreme Court overruled the Hochsprung case by the Krutzfeld case. The Court then construed the instrument as a whole and considered that 5% is 2/5ths of the usual 12 1/2% royalty. This is in harmony with the intent to convey a 2/5ths mineral estate and the Court concluded that such interpretation should be given the instrument.

Another example of adapting the grant to fit the lessors' royalty interest may be found in the following language:

(a) 1/2 of 1/8th of the oil produced.

(b) 1/2 of the oil and gas.

Here the lessor described literally the interest he desired to convey, that is, "1/2 of 1/8th" of all the oil produced. The last clause explained the intention of the parties by stating that the grantor and the grantee would each own 1/2 of the oil and gas mineral interest upon termination of the lease. A Kentucky Court held

[2] 266 P. 553.
[3] 284 P. 553.
[4] 290 P. 244.

that such a deed should be construed with relation to all of its parts and that it was effective to convey a ½ mineral interest. Note that the grant is of "all oil produced." This would not in itself convey a present interest in the minerals. The grant is contingent on oil being produced before it has anything upon which to operate. A royalty interest only is implied, therefore.

2. If a printed form of mineral deed is used which has blanks to be completed, be absolutely sure that the significance of each blank is considered for much misery may be caused by not respecting the potency of a harmless little four space blank. One such deed contained the following clauses:

(a) An undivided ⅛th of ⅛th royalty interest.

(b) Entitled to ⅛th of ⅛th of the royalty under existing lease.

(c) Upon termination of lease, will own ⅛th of ⅛th of the mineral interest.

Note that this is not ⅛th of ⅛th *of the* royalty interest. The lessee paid royalties on the basis of $\frac{1}{64}$th *of the* royalties paid or $\frac{1}{64}$th of ⅛th of total production. The grantee finally ventured the suggestion that he was entitled to ⅛th of the royalty, or $\frac{1}{64}$th of the entire production. The trial court agreed with the grantee's argument. Certainly the first clause is ambiguous in that it cannot be determined whether the parties intended to convey ⅛th of ⅛th, i. e., $\frac{1}{64}$th of the ⅛th royalty, or whether they intended to convey ⅛th of the ⅛th royalty. The last clause definitely states however, that the grantee was to receive ⅛th of ⅛th of the minerals upon lease termination. This would be a $\frac{1}{64}$th mineral interest. This mineral interest would be entitled to receive, therefore, $\frac{1}{64}$th of the usual ⅛th royalty, or 1/512th of all oil produced. The Supreme Court overruled the trial court on the basis of clause C and gave the grantee 1/512th of all production.[5] *Be careful in filling in forms.*

3. In preparing a conveyance or reservation include all the minerals which should be included. Many instruments reserve or convey the oil only, when the parties intend that oil and gas and possibly other minerals be included. Oil is to be distinguished from gas, as it is to be distinguished from gold or lead. A reservation of oil, ipso facto, does not include a reservation of gas also.

Because of the litigation resulting from the question of whether oil and gas include, for instance, casinghead gas or gasoline produced from gas, it is advisable that you employ phraseology such as "oil and gas and all other minerals" or in some instances where indicated, especially in royalty deeds, "oil, gas, casinghead gas and casinghead gasoline."

4. If a royalty interest in conveyed after lease, watch carefully that the interest is not restricted to the present lease. The landowner often times assumes that his lands will be proven or

[5] Jones v. Bedford, 56 S.W. 2d 305.

disproven during the existence of a lease and he consequently reserves, either mistakenly or purposely, royalties during the term of the lease only. Be very careful in drafting, and especially so when any reference is made to an existing lease, that no limitation in term is implied.

5. Care should be exercised where one owns a large tract of land which is under lease and sells a divided part of it. For instance, A owns Section 10 and he sells the NE¼NE¼ thereof to B, reserving to A ½ of the oil and gas that may be produced. Then he adds: "It is the grantor's intention that B shall have ½ of the royalties which may be paid under the terms of the oil and gas lease described herein." A's generosity is to be commended but his judgment is questionable. He has given away ½ of the royalties on 640 acres, whereas he has sold 40 acres only. In *Hoffman v. Magnolia Petroleum Co.*[6] this situation arose and the Court held that the grant must be construed against the grantor and that the grantee could have the royalties on the entire lease—not merely the tract sold. The solution is very simple. A should merely explain in his conveyance that B shall have ½ of the royalties from said lease as to the land being conveyed.

PROVIDED IN SOME LEASE FORMS

Many lease forms now provide that if a divided part of the leased premises are sold, then, nevertheless, lessee may pay rentals and royalties on the basis of the ratio which the amount of conveyed acreage bears to the entire leased premises.

6. Many thoughtless mistakes have explosive potentialities. H, a married man, is the sole owner of a tract of land. He does not live on the land, there is no homestead declaration, and it is not necessary that his wife join in a conveyance. Nevertheless, H sells, and his wife W joins in the conveyance. One-half of the minerals are reserved to "the grantors." In quick order, the land proves productive and H and W are divorced. W, thereupon claims to own the royalty interest jointly with H for the reservation is in her favor as much as in favor of H. Or another possibility is that W may die. Can a lessee safely pay all the rentals to H or should ½ of the rentals be paid to the representative of the deceased wife? The Illinois Supreme Court in *Saunders v. Saunders,*[7] held that where a wife who owned property in her own right was joined by her husband in conveying it, reserving a life estate to the grantors, the husband was entitled to the life estate after the death of the wife. To my knowledge there is no conclusive decision on this question. The case may be argued on the score that the mineral right is excepted, not reserved, and consequently title remains in the husband. It may be argued that the wife is a stranger to the title and that consequently a reservation in her favor is void. The question may be decided differently in those

[6] 273 S.W. 828 (Texas).
[7] 26 N.E. 2d 126.

states wherein the wife's signature is required. The situation should be avoided by careful drafting.

7. Always be careful as to correlation between the fractional interest conveyed and the number of mineral acres intended. Both of these should be checked against the accurate acreage of the land conveyed. A owns Blackacre, which is on a township correction line, it being the NE¼NE¼, Sec. 1. It consists of 38.50 acres. B, having just arrived from Texas, likes to use the term "mineral acres" and uses the following language, assuming Blackacre to consist of 40 acres:

> Grant ½ of the oil and gas and other minerals in, etc., it being the intention of the parties to convey 40 mineral acres.

The granting clause and the intention clause, of course, are contradictory for if a ½ interest is conveyed, then B only received 19.25 mineral acres. The Courts will construe the instrument as a whole and, because of the ambiguity contained in the instrument, receive evidence as to the intention of the parties. I personally have had more trouble with conveyances which actually recognized the problem and in which the draftsman sincerely showed his consideration for the problems of title lawyers in the following manner: In a lease covering, say, 2004.25 acres the lessor sells a 1002.125/2004.25 interest in the minerals to B. It is supposed that the use of this fraction, rather than a mere ½, which it is, apparently shows a much keener appreciation of the situation by the grantor. In any event, B in turn may sell a few proportionate fractional interests in order to eke out a small profit of one or two thousand per cent. His mathematics are poor and soon he dispenses with keeping the fraction in proportion. He sells to X a 10/2004.25 interest. It is then discovered that the leased premises actually contain 2008.47 acres. X is the proud owner, therefore of a $\frac{10}{2004.25} \times \frac{2008.47}{1}$ mineral interest. This is not fantasy—it happens quite often.

8. Until the law in Colorado is more settled, the specific nature of the estate conveyed or reserved should be described. Some instruments convey or reserve "mineral rights" or "oil rights". The question immediately arises: What are "oil rights?" Is this a fee estate in the oil or is it merely a right to receive proceeds from the production of oil? Does its owner have the right to lease—to receive delay rentals? The only thing certain in Colorado is that its owner doesn't lose whatever his interest is in the event of a subsequent tax sale. Therefore, describe the mineral interest being conveyed with the same care you would describe an automobile in a bill of sale. An instrument which conveys "rights" is indefinite and will remain so until the term is fully defined by our courts. The *Mitchell v. Espinosa*[8] case shows that the Colo-

[8] COLO. BAR ASSN. ADVANCE SHEET for March 22, 1952, p. 243.

rado Supreme Court construes a reservation of "oil rights" to cause a separation of the surface and mineral estate for the purpose of ad valorem taxation. This may imply that "oil rights" and "all oil and gas in and under the land" are the same.

CAVEAT EMPTOR

PHIL F. CARSPECKEN*

I am the Title—a faltering thing;
Buyer, beware, for I've taken my fling.

Linked with the land as the soul with the clod,
Strange and diverse were the paths I have trod;
Searchers, who followed my trail, were aghast,
Raking the muck of my dissolute Past.
Spotless was I when my journey was young—
Spotless no more as these stanzas are sung;
By-ways alluring and wayward and wild
Led me astray—but 'twas *Man* who defiled.

Men have relentlessly trifled with me,
Seeking to hold and enjoy me in fee—
Pawed me and clawed me and soiled me with shame,
Muddied my record and sullied my name.
Mine was the fate of a glittering toy,
Sought for and fought for like Helen of Troy;
Bankrupts have yielded me (not without smear)—
Bankers have eyed me with lecherous leer.

I've been the plaything of schemer and knave,
Sold on the block like Circassian slave—
Torn by dissension, partioned in shares.
Flung to a parcel of clamorous heirs.
Lawyers have toyed with me, tossed me about,
Jumbled me, fumbled me, sown me with doubt,
Wronged me with Error, and cast me away
Blotched with disease like a Dorian Gray.

Linked with the land, as the soul with the clod,
These were the devious paths I have trod—
"Unclean," the cry when my record was known—
(Who but a lawyer to cast the first stone.
Who but a lawyer to marshall my flaws,
Pleading the purge of the Curative Laws.)
Judges have sighed—and, with flourish of pen,
Made me a virtuous creature again.

I am the Title—a penitent thing;
Buyer, forgive—though I've taken my fling.

---

* Partner, Des Moines County (Iowa) Abstract Co.