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I. INTRODUCTION

> A seasoned real property practitioner once noted,
> A severance of the mineral estate may occur as the result of either a grant or reservation of the minerals, and determining whether a severance has in fact occurred or its extent may present a challenge even for the experienced title examiner. The distinction between a mineral interest and a royalty interest and which "minerals" are included in either are questions that continue to plague examining lawyers, and once those questions are answered the lawyer must concern himself with the validity and duration of the interest.[1]

While such comment would not long serve as an attention holder for many practitioners beyond a cocktail grouping of mineral lawyers, to the author of a deed which has given rise to one of the "plaguing" questions, a way to avoid curtain calls becomes a priority item. The purpose of this paper is to provide conveyancers with a sense of items to be considered when clients desire to convey or reserve interests in minerals, and thereby hopefully avoid center-stage billing in future case reports.[2]

If we begin with the proposition that a conveyance of land carries with it the entire surface and mineral estates unless a contrary intent appears[3],

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1. Nance, *Title Examination of Fee Lands Including Severed Mineral Interests*, ROCKY MTN. MIN. L. FOUNDATION MINERAL TITLE EXAMINATION INSTITUTE 3-1, 3-23 (1977).

2. Although mineral and royalty interests can be created in numerous other ways, such as by devise, eminent domain, or declaration of trust, the discussion herein will be in terms of conveyances and reservations. However, the drafting concerns and suggestions herein discussed are applicable to any instrument which purports to carve out a mineral, royalty or other interest.

3. Voyta v. Clonts, 134 Mont. 156, 162, 328 P.2d 655, 659 (1958).

then it is our intent to discuss some of the difficulties scriveners have encountered in expressing such contrary intent and in defining specific mineral and royalty interests.

Though we will speak of the "creation" of specific interests, it is more accurate to employ such terms as "severance", "carving out", or "separation" since all of the rights and interests involved are in existence as part of the full fee simple title. Yet, whatever term is used to describe the process, one should be leery of undertaking the drafting of language to accomplish the same without a clear understanding of the subject matter and the desired result. Mineral development is a high stakes/high reward endeavor. The lawyer can be assured that his or her drafting efforts will be closely scrutinized in the vent of development activity, and tested by litigation if uncertainty exists.

II. BASIC PRINCIPLES

A quick review of the basics regarding ownership of minerals is desirable before embarking upon a discussion of "severed" interests. First, the Montana Supreme Court has adopted Blackstone's statement that the owner of the full fee simple title to a parcel of land owns, "downwards, whatever is in a direct line, between the surface of [the] land and the center of the earth."[4] Thus, in Montana, the owner of land owns all substances which underlie the surface, including oil, gas and other minerals.[5]

"Ownership" is a collection of privileges and rights to use and enjoy property, including the right to dispose of the same.[6] It is well established that one or more of these rights can be severed from the others and owned, exercised and transferred as separate and distinct interests. In the same fashion, the mineral estate "may be segregated in whole or in part from the rest of the fee simple title," and the various incidents of the mineral estate in turn, "may be transferred separately."[7] Interests carved out of the mineral estate may be defined and limited in terms of strata, substances,

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4. Gas Products Co. v. Rankin, 63 Mont. 372, 389, 207 P. 993, 997 (1922); *see also* MONT. CODE ANN. § 70-16-101 (1987) (stating that "[t]he owner of land in fee has the right to the surface and to everything permanently situated beneath or above it").

5. *Gas Products Co.*, 63 Mont. at 393, 207 P. at 998; Homestake Exploration Corp. v. Schoregge, 81 Mont. 604, 614, 264 P. 388, 391 (1928). This is the universal rule in the United States as concerns solid or "hardrock" minerals, with the exception of extralateral rights appurtenant to lode mining claims, 54 AM. JUR. 2D, *Mines and Minerals* § 1 (1971). In the oil and gas context, the Montana approach is referred to as the "ownership-in-place" theory. McDonald v. Unirex, Inc., ____Mont. ____, 718 P.2d 316, 317 (1986). Some states have adopted a "nonownership" theory. 1 M. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 203 (1986).

6. *In re* Hunter's Estate, 125 Mont. 315, 324, 236, P.2d 94, 99 (1951); *see also* Energy Oils, Inc., v. Montana Power Co., 626 F.2d 731, 736 (9th Cir. 1980).

7. Stokes v. Tutvet, 134 Mont. 250, 256, 328 P.2d 1096, 1099-100 (1958).

duration, manner of use and enjoyment, or all of these.[8] The variety of interests which can be created is restricted only by the desires and purposes of the owners, the skill and imagination of their lawyer, and a few rules of property (such as the rule against perpetuities).

As a final "basic matter", the attitude of the Montana court in adjudicating conveyancing disputes must be kept in mind. Early in the history of this state, the court adopted the general rule of law that a grantor's intent is to be ascertained if possible from an examination of the document itself.[9] For many years, the court was rather consistent in its application of the rule that the parties' intent was to be garnered from the four corners of the instrument in question. However, the court recently has taken to the practice of declaring language ambiguous and resorting to extrinsic evidence in its efforts to ascertain the intent of the parties.[10] This *ad hoc* approach has seemingly now become the rule of choice in conveyancing cases.[11] Thus, if the conveyancer is to have the last word on the issue (as he or she should), all efforts must be directed to ensuring that the drafted language can withstand the careful scrutiny which will accompany mineral development.

III. Definition and Nature of Interests That May Be Created

The terms most frequently encountered by conveyancers—minerals and royalty—describe the two basic interests. However, between these interests are numerous variations and the lines of demarcation are not always distinct.[12]

A. *Mineral Interests*

The most complete mineral interest is the full mineral fee estate. In addition to ownership of minerals in place, the mineral estate is comprised of a number of elements or incidents—the collection of rights, powers and privileges which make up the estate—enumerated by the Montana court as follows:

> 1. The right to go upon the land, conduct exploratory operations, and produce. . .(the development right). If there is a subsisting. . .[development agreement], this right is subject

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8. 1 E. Kuntz, A Treatise on the Law of Oil and Gas § 3.1 (1987).

9. Hollensteiner v. Missoula Lumber Co., 37 Mont. 278, 96 P. 420 (1908).

10. *Cf.* Crawford v. Griffith, 137 Mont. 140, 351 P.2d 223 (1960); Adams v. Chilcott, 182 Mont. 511, 597 P.2d 1140 (1979); Procter v. Werk, ____Mont. ____, 714 P.2d 171 (1986).

11. *See* Peterson v. Hopkins, ____Mont.____, 684 P.2d 1061 (1984).

12. The Montana court has acknowledged that its decisions attempting to distinguish between mineral and royalty interests are less than clear. *Stokes*, 134 Mont. at 256-263, 328 P.2d at 1100-1103.

> thereto, but may be exercised if and when the. . .[development agreement] terminates;
> 2. The right to execute. . .[a development agreement] (the executive right). If there is a subsisting. . .[development agreement] this right is also subject thereto;
> 3. The right to a share in the bonus under future. . .[development agreements];
> 4. The right to a share in the rentals under existing and future. . .[development agreements].
> 5. The right to a share in the royalties under existing and future. . .[development agreements].[13]

A critical aspect of the development right is the right to enter upon the surface of the land and use as much as is reasonably necessary for exploration, development and production of minerals.[14] This right to use the surface, commonly referred to as the exploration and development easement, constitutes a burden on the surface estate, and will be implied when not specifically included in the instrument which severs the mineral estate from the surface estate.[15] As discussed below, one must keep in mind that the relationship between the surface and the mineral estates can be defined within the severance instrument.

The foregoing discussion is applicable to not only full mineral fee estates, but also to fractional mineral interests.[16]

B. *Royalty Interest*

Unlike mineral interests, a royalty interest is not an ownership interest in the minerals in place,[17] but rather constitutes a share of production, in kind or in value, if and when mineral production occurs.[18] A royalty interest can be carved out of the mineral estate either before or after execution of a development agreement, such as an oil and gas lease, or can be created as an element of consideration for the execution of a mineral lease.[19] A royalty created in connection with the issuance of a mineral lease is normally limited to the duration of the lease, while a royalty interest

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13. *Stokes*, 134 Mont. at 256, 328 P.2d at 1100 (quoting R. SULLIVAN, HANDBOOK OF OIL AND GAS LAW 208 (1955)).

14. Hurley v. Northern Pacific Railway Co., 153 Mont. 199, 202, 455 P.2d 321, 323 (1969).

15. Western Energy Co. v. Genie Land Co., 195 Mont. 202, 208, 635 P.2d 1297, 1301 (1981).

16. A fractional mineral interest is an undivided share of the ownership of the minerals in place and of the incidents thereof, i.e., a cotenancy interest in the mineral estate. Marias River Syndicate v. Big West Oil Co., 98 Mont. 254, 265, 38 P.2d 599, 602 (1934); *see also* Amundson v. Gordon, 134 Mont. 142, 149, 328 P.2d 630, 634 (1958).

17. Rist v. Toole County, 117 Mont. 426, 434-436, 159 P.2d 340, 343-345 (1945); *see also* Richardson v. Richland County, ____Mont.____, 711 P.2d 777, 781 (1985).

18. *Voyta*, 134 Mont. at 164, 328 P.2d at 660.

19. *Stokes*, 134 Mont. at 257, 328 P.2d at 1100; *see also Proctor*, ____Mont. at ____, 714 P.2d at 173.

carved from the mineral estate without reference to a specific development agreement is usually referred to as a "perpetual nonparticipating royalty".[20] The term "nonparticipating" has reference to development, and as such, royalty interests are most commonly a fraction of gross production free of development costs.[21] However, they can be quantified in any number of ways.[22]

Aside from the above-stated distinctions between mineral and royalty interests, the principal economic difference is in the quantity of production or production proceeds to which each would be entitled upon discovery in commercial quantities. For example, comparing a 5 per cent mineral interest with a 5 per cent royalty interest (assuming production under an oil and gas lease in which a proportionately-reducible[23] 12.5 per cent royalty was reserved), out of every 100 barrels of oil produced the 5 per cent mineral owner is entitled to only .625 barrels of oil (5% of 12.5), while the royalty owner is entitled to 5.0 barrels (5% of 100).[24]

C. *Hybrid Interests*

Numerous variations of mineral and royalty interests, carrying genes of each, can be created. For example, a nonexecutive mineral interest has royalty characteristics in that is does not include the executive right, and generally would not include the executive right, and generally would not include the development right.[25] Typically, a nonexecutive mineral interest

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20. Edward v. Prince, ____Mont.____, 719 P.2d 422, 424 (1986); *see also Stokes*, 134 Mont. at 258, 328 P.2d at 1101.

21. *See, e.g.*, McSweyn v. Musselshell County, ____Mont.____, 632 P.2d 1095 (1981). Although a royalty is usually a share of gross production free of the cost of discovery and production (Smith v. County of Musselshell, 155 Mont. 376, 472 P.2d 878 (1970)), questions arise as to whether costs of transportation, gathering, processing and treating are chargeable to the royalty owner (West v. Alpar Resources, Inc., 298 N.W.2d 484 (N.D. 1980)), whether the royalty owner is chargeable with production-related taxes (Forbes v. Mid-Northern Oil Co., 100 Mont. 10, 45 P.2d 673 (1935)), and even as to how the amount payable should be calculated (Montana Power Co. v. Kravik, 179 Mont. 87, 586 P.2d 298 (1978)). Although these issues are often not addressed in the instruments creating the royalty interest, they are certainly candidates for express treatment depending upon the degree of sophistication appropriate to the transaction.

22. Other than a fraction of gross production, royalties can be measured in terms of a percentage of net profits, a percentage of net proceeds, a fixed amount per unit of production, an amount based on contained value, a percentage of net smelter returns, a percentage of value at some intermediated point, or on any other basis the parties devise. For each stated method of measurement the formula for calculating the royalty should be set forth in detail, particularly where the method of measurement has not been established by industry practice and case law. *See* Henderson, *Drafting Mining Agreements: Royalties and Related Drafting Issues*, 3 NAT. RESOURCES & ENV'T 12 (1988).

23. Most oil and gas leases routinely contain a clause intended to relate the stated royalty to the lessor's mineral ownership.

24. Clough v. Jackson, 156 Mont. 272, 283, 479 P.2d 266, 272 (1971); *see also Voyta*, 134 Mont. at 164, 328 P.2d at 660.

25. 2 WILLIAMS & MEYERS, *supra* note 5, § 321. *But see Id.* § 304.10.

owner would be entitled to bonuses and rentals, as well as royalties, under any lease executed by the owner of the executive right.[26] In the production example set forth above, a 5 per cent nonexecutive mineral interest owner is entitled to only .625 barrels of oil[27], although such interest might otherwise be very similar to a royalty interest.

Creatable interests not only may contain indicia of both basic types of interests, they may also be defined to last in perpetuity or for limited terms (e.g., fixed terms, life estates, or a specified number of years and so long thereafter as minerals are produced), and may be restricted to cover only specified minerals or strata. Yet, in every case the attorney's task is to advise the client of the options available and devise language which clearly expresses the client's intent.

IV. LEGAL REQUISITES FOR CREATING MINERAL AND ROYALTY INTERESTS

As mineral interests constitute real property,[28] and royalties are interests in real property,[29] transfers of these interests must satisfy the usual requirements for a conveyance of real property, i.e., an executed written instrument, a grantor, a grantee, words of grant, an adequate description of the property, an acknowledgment for recording purposes, delivery and acceptance.[30]

At common law the various parts of a deed had specific purposes and limitations, and a clear distinction was made between exceptions and reservations with rules for the content, usage, effect and placement of each. However, the Montana court has expressly rejected these technical rules

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26. 1 KUNTZ, *supra* note 8, § 15.3 (referring to the interest as a "nonparticipating mineral interest").

27. 2 WILLIAMS & MEYERS, *supra* note 5, § 327.3.

28. *Stokes*, 134 Mont. at 255, 328 P.2d at 1099; *see also* Willard v. Federal Surety Co. 91 Mont. 465, 471, 8 P.2d 633, 635 (1932)

29. While royalties do not constitute title to minerals in place, and though there may be some question as to whether royalties should be classified as real property or personal property, there seems to be no doubt that royalties will be treated as interests in real property to the extent that rules applicable to transfers of interests in real property will govern royalty transfers. *Compare Rist*, 117 Mont. at 432, 159 P.2d at 343-345 (indicating that: (a) a royalty does not constitute title to real property, (b) is an interest in the personal property produced, and (c) is in the nature of a profit a prendre) *with* Pluhar v. Guderjahn, 134 Mont. 46, 51, 328 P.2d 129, 132 (1958) (holding that an assignment of royalty falls within the definition of a conveyance of real property for purposes of the recording laws), Mitchell v. Pesta, 123 Mont. 142, 147-48, 208 P.2d 807, 809-10 (1949) (applying an after-acquired title statute pertaining to real property to a royalty conveyance) and *Edward*, ____ Mont. at ____, 719 P.2d at 424 (1986) (applying a statute of interpretation applicable to grants of real property to a royalty transfer).

30. *See, e.g.*, Hodgkiss v. Northland Petroleum Consol, 104 Mont. 328, 332-33, 67 P.2d 811, 813-14 (1937) (necessity of a proper grantee in a mineral deed); *see also* 3 AM. LAW OF MINING § 82.01(4) (1987).

and distinctions in favor of a rule which effectuates the parties' intent to the extent it can be ascertained.[31]

However, this is not to say that placement of a reservation in a deed is unimportant. Indeed, placement may be critical in the interpretation of a conveyance. For example, if exception language is located immediately following a warranty clause, there is substantial risk that the language will be viewed by a court as solely an exclusion from the warranty.[32]

In every conveyance involving mineral or royalty interests, the conveyancer must ensure that all requirements of a real property transfer are satisfied. Furthermore, although many technical rules of conveyancing either have been abandoned or are in the process of being abandoned as the result of a strong present policy favoring the intent of the parties, vestiges of the technical rules still remain and may have an impact upon the interpretation of the conveyance.

The common law rule disfavoring reservations in favor of a stranger to title is illustrative of the problems created if proper attention is not paid to developing judicial trends when drafting mineral and royalty reservations. In recent years, to effectuate the intent of the parties, a number of jurisdictions have rejected the rule that a reservation cannot be made in favor of a stranger to title.[33] While the Montana court has not overturned the rule in the context of mineral or royalty reservations, it has announced that it "will depart from that rule to give effect to the grantor's intent [where the intent of the grantor is] clearly shown."[34]

There is little doubt that the Montana court would recognize a reservation in favor of a stranger where intent is adequately shown. However, the careful draftsman can completely avoid this question by using words of grant in favor of the party who is to receive the subject interest. And, there is no rule which would prevent such a grant from being included in a deed conveying other interests to another grantee.

As is often the case when a fisherman pulls one worm out of the tobacco can, he finds a whole ball of worms also seeking to exit. Tugging on the one worm, rejection of the rule against reservations in favor of strangers, leads to the problems raised by the common practice of spousal

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31. Krutzfeld v. Stevenson, 86 Mont. 463, 474, 284 P. 553, 555 (1930) (rejecting the technical distinctions between the various parts of a deed in order to implement the intent of the grantor); *see also Marias River Syndicate*, 98 Mont. at 263-64, 38 P.2d at 601 (disregarding the technical distinction between exceptions and reservations in order to give effect to the grantor's intent).

32. *See, e.g.*, Mueller v. Strangeland, 340 N.W.2d 450 (N.D. 1983).

33. *See* Malloy v. Boettcher, 334 N.W.2d 8, 9-10, (N.D. 1983); *see also* Willard v. First Church of Christ, 7 Cal.3d 473, 498 P.2d 987, 102 Cal. Rptr. 739 (1972).

34. Medhus v. Dutter, 184 Mont. 437, 444, 603 P.2d 669, 673 (1979). In *Medhus*, the court found that the showing of intent to create an easement by reservation in favor of a stranger was not sufficiently clear.

joinder in deeds. When a husband or wife conveys his or her separate property the spouse customarily joins in the deed to release spousal rights, and the deed often collectively names the two as "grantors" or "first parties". Frequently, a reservation in such a deed commences with "reserving to grantors" or "reserving to first parties." Such reference places the fat in the fire.

As the rule denying effect to reservations in favor of strangers is either dead or dying in Montana, will such a reservation in the spousal situation inure to the benefit of the non-owning spouse? A strict reading would dictate a "yes" response, while a "no" answer finds strong support in the argument that the reasons for spousal joinder and the common practice of naming the non-owning spouse as one of the grantors preclude the reservation language from sufficiently expressing an intent that the reservation is to benefit the non-owning spouse.[35] Howver, the North Dakota court when faced with this issue held that such a reservation did inure to the benefit of the non-owing spouse.[36]

The conveyancer should leave no doubt when drafting a deed to be joined by a non-owning spouse that either, (a) the reservation is not intended to benefit the non-owning spouse, or (b) by the inclusion of appropriate words of grant and expressed intent, the reservation is intended to run in favor of the non-owning spouse.

V. SUBSTANCES COVERED BY THE TERM "MINERALS"

Typically, mineral and royalty reservations and conveyances apply to "oil, gas and other minerals",[37] or "all minerals."[38] Since the word "minerals" does not carry a well-defined, well-established meaning, a practitioner must be concerned with what substances are intended to be covered when clients request drafting services and advice involving minerals and royalties.[39] The few Montana cases on point teach that "minerals" includes oil and gas,[40] and may or may not include sand and gravel depending upon the intent of the parties as shown by extrinsic

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35. *Id.*

36. *Malloy*, 334 N.W.2d at 8.

37. *See, e.g.*, Broderick v. Stevenson Consolidated Oil Co., 88 Mont. 34, 36, 290 P. 244, 244 (1930).

38. *See, e.g.*, Superior Oil Co. v. Vanderhoof, 307 F.Supp. 84, 85 (D. Mont. 1969).

39. *See*, Reeves, *The Meaning of the Word "Minerals"*, 54 N.D.L.REV. 419 (1978), *reprinted in* 16 PUB. LAND & RESOURCES L. DIG. 10, 14 (1979); *see also* Annotation, *Grant, Lease, Exception, or Reservation of "Oil and Gas, and Other Minerals," or the Like, as including Coal or Metallic Ores*, 59 A.L.R.3D 1146, 1150 (1974).

40. Texas Pacific Coal & Oil Co. v. State, 125 Mont. 258, 260, 234 P.2d 452, 453 (1951); Mid-Northern Oil Co. v. Walker, 65 Mont. 414, 427, 211 P. 353, 356 (1922); Rice Oil Co. v. Toole County, 86 Mont. 427, 431, 284 P. 145, 146 (1934).

evidence.[41] Although the Montana court's experience with this issue is limited, courts from other jurisdictions have repeatedly faced the matter with inconsistent results.[42]

Various approaches and criteria have been utilized by the courts in determining whether a particular substance is included within a reservation or conveyance of "minerals", with the theoretical goal in each case that of discerning the intent of the parties.[43] Since this intent is not clear from the language used—indeed, specific intent as to unnamed substances is probably nonexistent—courts have turned to various rules of construction.[44] Traditional rules of construction which have been utilized include: the ordinary and natural meaning test;[45] the *ejusdem generis* rule (meaning of general terms restricted by specific words preceding them);[46] and the rule by which deeds are construed against the grantor.[47] In general, such rules are not productive of consistent results, often point in opposite directions, fail in many cases to effectuate intent and fail to take into account important factors and goals.[48]

Accordingly, some courts have favored approaches more specifically designed for the task of ascertaining the meaning of the term "minerals", utilizing criteria based upon the recognition in the community of a substance as a mineral,[49] the knowledge of the parties as to the presence of the substance in question,[50] economic value apart from the surface itself,[51]

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41. Adams v. Chilcott, 182 Mont. 511, 597 P.2d 1140 (1979).

42. For a summary of the cases on this issue, see Reeves, *supra* note 39. *See also* Patterson, *A Survey of Problems Associated With Ascertaining The Ownership of "Other Minerals"*, 25 ROCKY MTN. MIN. L. INST. 21-1 (1979).

43. Patterson, *supra* note 42, at 21-3.

44. Laue, *Interpretation of "Other Minerals" in a Grant or Reservation of a Mineral Interest*, 71 CORNELL L.REV. 618 (1986), *reprinted in* 23 PUB. LAND & RESOURCES L.DIG. 202, 203-205 (1988).

45. *See, e.g.*, Moser v. United States Steel Corp., 676 S.W.2d 99, 102 (Tex. 1984) (uranium is a mineral within the ordinary and natural meaning of the word); *cf.* Mack Oil Co. v. Laurence, 389 P.2d 955, 961 (Okla. 1964) (water not within ordinary meaning of the word).

46. *See, e.g.*, Vogel v. Cobb, 193 Okla. 64, 67, 141 P.2d 276, 280, (1943) (*ejusdem generis* applied to hold water is not included in "oil, petroleum, gas, coal, asphalt and all other mineral"); Keeler v. Ely, 192 Kan. 698, 701, 391 P.2d 132, 135 (1964) (*ejusdem generis* applied to hold gypsum included in reservation of "all minerals").

47. *See, e.g., Keeler*, 192 Kan. at 701, 391 P.2d at 135; *cf.* MONT. CODE ANN. § 70-1-516 (1987) which adopts this rule, but provides that a reservation is to be interpreted in favor of the grantor.

48. Lowe, *What Substances are Minerals?*, 30 ROCKY MTN. MIN. L. INST. 2-1, 2-6 through 2-11; *see also* Laue, *supra* note 44, at 204-219.

49. *See, e.g.*, Missouri Pacific Railroad v. Strohacker, 202 Ark. 645, 152 S.W.2d 557 (1941)(oil and gas not covered by a reservation of "all coal and mineral deposits" because those substances were not commonly recognized in the area as minerals).

50. *See, e.g.*, Detlor v. Holland, 57 Ohio St. 492, 504, 49 N.E. 690, 692 (1898) ("other valuable minerals" did not include oil where neither party knew of its existence).

51. Vang v. Mount, 300 Minn. 393, 400, 220 N.W.2d 498, 502 (1974) (evidence of the value of the limestone in question was pertinent as to whether it was included in a reservation of "all minerals").

and the effect upon the surface estate.[52] These formulations, although more in tune with the realities of the issue than traditional rules of construction, are also unsatisfactory from many viewpoints.[53]

As indicated above, the decisions of the Montana court provide little guidance in this area. However, *Adams v. Chilcott*[54] suggests the approach that the court likely may follow in future cases,. The question before the court was whether sand and gravel are included within a reservation covering, "oil, gas and mineral rights."[55] The court "decline[d] to announce an applicable rule in Montana. . . ."[56] It determined that "[t]he split of authority, the voluminous litigation the issue has caused and the absence of pertinent Montana case law indicate that the term 'mineral', as applied to sand and gravel, is inherently ambiguous."[57] Therefore, extrinsic evidence of the parties' intent will control the result.[58]

Thus, it can be argued that in Montana the term "minerals" is ambiguous with respect to virtually any substance not specifically mentioned (except possibly oil and gas)[59]. Although making every effort to ascertain the parties' intent is laudable, to permit extrinsic evidence of the parties' intent in each case not only creates great uncertainty with respect to land titles, it also requires that the issue be litigated each time it arises.[60]

The above discussion briefly demonstrates the nature of the problem and the difficulties that it has posed for the courts. Thus, the draftsman should, to the extent possible and practical, avoid this quagmire for his client.

As a practical matter, the parties to the proposed transaction have probably not formulated a specific intent with respect to the substances to be covered by the reservation or conveyance, except for a few prevalent in the vicinity of the property.[61] That is, parties to a mineral or royalty transaction covering land in eastern Montana very likely have in mind oil, gas and coal, while their counterparts in a hard-rock mining area are probably contemplating metalliferous minerals such as gold, silver, and copper.

As a starting point, the scrivener should inquire as to the specific

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52. Acker v. Guinn, 464 S.W.2d 348, 352 (Tex. 1971) (excluding iron ore from a grant of "oil, gas and other minerals" where the removal of the ore would "consume or deplete the surface estate").

53. Laue, *supra* note 44, at 204-19; *see also* Lowe, *supra* note 48, at 2-6 through 2-11.

54. 182 Mont. 511, 597 P.2d 1140 (1979).

55. *Id.* at 517, 597 P.2d at 1144.

56. *Id.*

57. *Id.*

58. *Id.*; *see* MONT. CODE ANN. § 70-20-202 (1987).

59. Oil and gas, at least in the usual case, are apparently covered by the term "minerals". *See supra* text accompanying note 40.

60. *See* Laue, *supra* note 44, at 214-16.

61. Lowe, *supra* note 48, at 2-3 through 2-5.

substances the parties to the reservation or conveyance have in mind. With this information, the possibility of limiting the reservation or conveyance to the contemplated substances should be explored. This generally will be consistent with the economics of the transaction, since these normally are the substances for which the deal has been struck. If this approach is followed, the language of the reservation or conveyance should be expanded to include associated substances occurring or produced with the enumerated substances.

If the parties wish to cover "all minerals", in essence all substances except the soil itself, the following language may be considered:

> "All minerals" as used herein shall include all known and unknown substances which are now, or may in the future become, intrinsically valuable, that is, valuable in themselves aside from their location within the earth, and which are now or may be in the future enjoyed through extraction from the earth, whether or not such extraction damages or destroys the surface.[62]

The parties must be given the opportunity to exclude from this broad formulation certain items such as sand, gravel, clays and bentonite, which are so often considered more a part of the surface estate than the mineral estate.[63] Because effects of exploration and development upon the surface have often influenced the determination of what substances are covered, we believe explicit treatment must be given this matter as well. Effects of mineral exploration and development upon the surface will be treated in greater detail below.

If the parties are more comfortable with a traditional approach, but they nevertheless wish to cover "all minerals", an expansive statement of the minerals covered together with express inclusion and exclusion of all substances actually considered by the parties and an express statement concerning impact upon the surface should be used. The following language is recommended:

> "All minerals" as used herein shall include every mineral of whatsoever description, nature of kind, whether known or unknown, whether occurring in a gaseous, liquid or solid state, whether metalliferous, nonmetalliferous, hydrocarbon or nonhydrocarbon, whether similar or dissimilar to the minerals hereafter enumerated, regardless of the manner of extracting the same and regardless of whether such extraction damages or destroys the surface, including but not limited to oil, gas, coal, gold, silver, nickel, copper, and iron but expressly excluding sand, gravel, bentonite and clay.

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62. Adapted from language suggested by 1 KUNTZ, *supra* note 8, § 13.3, at 385.

63. As stated by the Montana court in *Adams*, "extra care should be taken to expressly include or exclude sand and gravel from the term 'mineral'." 182 Mont. at 517, 597 P.2d at 1144.

Whether utilizing one of the approaches suggested above or by some other means, the draftsman must avoid the "inherently ambiguous" nature of the term "mineral".[64]

VI. Creating the Interest Intended—Mineral Vs. Royalty

Probably the most litigated issue concerning mineral and royalty conveyances and reservations is the fundamental question of whether the language used creates a mineral or royalty interest. Because draftsmen in the past have had such difficulty with this issue and early case law was confusing, the resulting precedent now stands as guideposts in Montana which delineate a route by which this question can be avoided.

As discussed above, whether an interest is a mineral or royalty interest is of major economic consequence. A royalty owner is entitled to only a share of production if and when production occurs, while a mineral interest constitutes ownership of minerals in place and carries with it the development and executive rights, and the right to bonuses, rentals and royalties under any mineral lease. Although a mineral interest includes more incidents of the mineral estate, a specified fractional interest carries more economic benefit as a royalty than as a mineral interest from a production point of view.[65]

The essential distinction between royalty and mineral interests provides the framework for ensuring that the intended interest is created. As stated by the Montana court in *Stokes v. Tutvet*:

> Since "royalty" and "non-participating royalty" are shares in production only, certain words denoting a share in production have been used to delimit the interest conveyed. Likewise, a mineral interest being a severing of the mineral fee is often described in terms of ownership under the ground. Thus, "produced and saved" have been associated with royalties, "oil and gas in and under and upon" the land, have been associated with a mineral interest.[66]

Thus, to create a mineral interest the scrivener should utilize the terminology, "in and under and upon", while the creation of a royalty interest is accomplished by use of "produced and saved", or words of similar import.

Although the language set forth above is of "primary importance" in making a clear distinction between mineral and royalty interests,[67] the courts have looked at many other factors, most of which are derived from the nature of the interests. For example, a mineral interest is evidenced by

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64. *Id.*

65. *See supra* text accompanying notes 12-27.

66. 134 Mont. at 259, 328 P.2d at 1101.

67. *Superior Oil Company*, 307 F.Supp. at 90; *see also* Mitchell v. Hannah, 123 Mont. 152, 157, 208 P.2d 812, 814 (1949).

express inclusion of exploration and development easements, the right to receive bonuses and rentals, and the development and executive rights.[68] Since royalties are generally a cost-free fraction of mineral production, if and when produced, and since the mineral interest owner (or a lessee) must incur exploration and development costs to realize a benefit, the Montana court has stressed the significance of the presence or absence of language which renders the interest "free and clear of the costs of its discovery and production."[69] Such language is recommended in the creation of royalty interests.

The seminal case of *Marias River Syndicate v. Big West Oil Co.*[70] had the effect of placing Montana in the minority with respect to the effect of the use of the term "royalty". In *Marias River*, the court construed a reservation to be a mineral despite other indicia of a royalty interest.[71] The Montana Supreme Court, somewhat reluctantly, has followed this precedent of placing little or no significance on the use of the term "royalty".[72] Accordingly, one should not rely on the terms "royalty " or "landowner's royalty" as sufficient in and of themselves to create a royalty interest.[73]

Construction problems most often arise when the instrument in question mixes indicia of both mineral and royalty interest. Indeed, from our experience and the reported cases there apparantly has been a long-standing practice in Montana of combining "in, on and under" type language with "produced and saved", or similar words.[74] Although such a combination will generally be construed as creating a mineral interest,[75] a strong possibility exists that such language will be viewed as ambiguous with the result that extrinsic evidence of intent is admissible to establish a royalty interest.[76] In view of the Montana court's propensity to favor

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68. *Superior Oil Company*, 307 F.Supp. at 90; *see also Marias River Syndicate*, 98 Mont. at 266-67, 38 P.2d at 602; *see also* Crawford v. Griffith, 137 Mont. 140, 144, 351 P.2d 223, 225 (1960) (reservation by the grantors of the right to lease and control of the minerals was indicative that a 100% mineral interest had been reserved).

69. *Marias River Syndicate*, 98 Mont. at 265, 38 P.2d at 601; *see also* Smith v. County of Musselshell, 155 Mont. 376, 380, 472 P.2d 878, 881 (1970).

70. 98 Mont. 254, 38 P.2d 599 (1934).

71. *Id.* at 264, 38 P.2d at 601.

72. *Stokes*, 134 Mont. at 262, 328 P.2d at 1103 (term "landowner's royalty" was not given effect as creating a royalty interest.)

73. *Recent Montana Decisions*, 21 MONT. L. REV. 125, 129-31 (1959).

74. *See, e.g., Marias River Syndicate*, 98 Mont. at 264, 38 P.2d at 601; *McSweyn*, ____ Mont. at ____, 632 P.2d at 1096 (1981).

75. *See, e.g.*, Marias River Syndicate v. Big West Oil Co., 98 Mont. 254, 38 P.2d 599; Smith v. County of Musselshell, 155 Mont. 376, 472 P.2d 878 (1970); Amundson v. Gordon, 134 Mont. 142, 328 P.2d 630 (1958).

76. *Superior Oil Company*, 307 F.Supp. 84 at 90-91 (extrinsic evidence considered in determining that, "a reservation of six and one-fourth percent (6 ¼ %) of all minerals contained in and hereafter mined, produced, extracted or otherwise taken" created a royalty interest); *see* MONT. CODE ANN. § 70-20-202 (1987).

admission of extrinsic evidence in the ascertaining of intent[77] even though such an approach sacrifices certainty of titles, words such as "in, on and under" should never be combined with words like "produced and saved." Referring simply to "oil and gas rights" or "mineral rights" tends to have the effect of creating mineral interests, even though the terms, "in, under and upon" are not used.[78]

However, we believe such "short forms" can be ambiguous in some circumstances, and caution against relying upon the same. Likewise, we caution against the use of "all mineral rights" or similar language if the intent is to convey or reserve all interests pertaining to minerals whether they be mineral or royalty or both. In this case the language should clearly indicate that all mineral *and* royalty interests are conveyed or reserved.

The above analysis assumes the creation of pure mineral or royalty interests. As discussed earlier, creating hybrid interests with incidents of both mineral and royalty interests is possible.[79] Where this is the goal of the parties, careful drafting is essential. In this effort, the terms of art discussed above are not as useful. To create a hybrid-type interest, the draftsman must have in mind all the elements of the mineral estate and should expressly either include or exclude each element. In addition, since the traditional legal relationships associated with royalty and mineral interests may not be appropriate or relevant, the draftsman must consider whether the instrument should expressly set forth these relationships. For example, where the executive right is severed from a mineral interest, creating a non-executive mineral interest, it may be wise to delineate the extent of the executive's obligations to the non-executive mineral owner with respect to the decision to lease and the amount of bonus, rental and royalties under a lease.[80] A complete and clearly-expressed statement of all the elements of

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77. *Stokes*, 134 Mont. at 263, 328 P.2d at 1103 (1958) (reservation held ambiguous based upon extrinsic evidence, contrary to the usual approach of only considering extrinsic evidence when the language itself is determined to ambiguous); *see also Crawford*, 187 Mont. at 144-45, 351 P.2d at 225 (the court announced: "It is the duty of the courts, and the intention of the law, that the intent of the parties be enforced as far as possible. The tendency of modern decisions is to disregard technicalities and to treat all uncertainties in a conveyance as ambiguities subject to be cleared up by resort to the intention of the parties as gathered from the instrument itself, the circumstances attending and leading up to its execution, and the subject matter and the situation of the parties as of that time"); *see also Recent Montana Decisions*, 21 MONT. L. REV. 125, 128-129 (1959).

78. Wyrick v. Hoefle, 136 Mont. 172, 346 P.2d 563 (1959) ("oil and gas rights"); Amundson v. Gordon, 134 Mont. 142, 328 P.2d 630 (1958) ("mineral rights").

79. *See supra* text accompanying notes 25-27.

80. Since there are no Montana cases dealing with a non-executive mineral interest, the creation of such an interest in Montana should be approached with extreme care. A number of questions beyond the scope of this article should be considered, including (but not limited to) applicability of the rule against perpetuities, the duration of the severance of the executive right, whether the executive right is personal in nature, the obligations of the executive to the non-executive, and the quantum of production to which the non-executive is entitled. *See* Bledsoe, *Conveyancing of Oil and Gas Interests*, 32 OIL AND

the hybrid interest and the attendant legal relationships should be included in the instrument of creation.

In summary, creation of a pure mineral interest can be accomplished by use of the words, "in, on and under", and we suggest that a statement of exploration and development easements be added as well. A traditional royalty interest will be created by the language "x per cent royalty of all minerals produced and saved, free of cost of exploration, development and production." Words indicative of a mineral interest should never by mixed with royalty-type words. Shorthand attempts to create a hybrid interest should be avoided in favor of an express statement of the incidents to be included and excluded, and of the legal relationships intended. In the creation of any interest, be it mineral, royalty, or hybrid, the instrument of creation should be examined in its entirety to insure that it contains nothing which is inconsistent with the interest intended and nothing which might create an ambiguity.[81]

VII. FRACTIONAL INTEREST/QUANTUM OF INTEREST

Fractional interest questions can present difficult and complex problems for the mineral conveyancer, and a result which may be perfectly obvious to one person or court may be doubtful to another. In this area, the best advice is to proceed with extreme caution, double-check all assumptions and conclusions, attempt to identify all possible results of the language used and make clarifying revisions until there can be no doubt as to the result intended. In this section, we will deal with only a sampling of the fractional-interest type problems which can arise. Our purpose is to provide a flavor for the concerns the attorney should keep in mind, without providing an exhaustive catalog of possible fractional interest issues.

A critical factor in most, if not all, fractional-interest issues is the status of the grantor's title at the time of the conveyance in question. Obviously, the scrivener should know with a fair degree of certainty the status of the grantor's title, but in many cases ascertaining title status may not be practical or the information available may not be completely reliable. In these cases, the conveyancer must attempt to draft the conveyance or reservation such that the desired result is reached under any one of several reasonably possible title situations.

GAS L. AND TAXATION INST. 83, 91-92 (1981); *see also* 1 KUNTZ, *supra* note 8, § 15.7; 2 WILLIAMS & MEYERS, *supra* note 5, §§ 321-330.

81. *See* Musselshell Valley Farming & Livestock Co. V. Cooley, 86 Mont. 276, 294, 283 P. 213, 218 (1929) ("[e]very intention of the parties to a deed is to be ascertained, if possible, from its language, not as it is presented in particular sentences or paragraphs, but according to its effect when viewed as in entirety"); *see also Crawford*, 137 Mont. at 144-45, 351 P.2d at 225 (in determining the intentions of the parties, the instrument will be considered as a whole and all clauses taken into consideration and all uncertainties will be treated as ambiguities subject to clarification by extrinsic evidence.)

A. Duhig[82] *Rule*

The classic fractional-interest problem is presented by the following situation: A grantor who owns 100 per cent of the surface but only 50 per cent of the minerals executes a general warranty deed reserving to himself 50 per cent of the minerals, without mention of the fact that 50 per cent of the minerals are owned by someone else. At first blush, one reading this deed would conclude that the grantor reserved to himself the remaining 50 per cent mineral interest, but the Texas court in *Duhig v. Peavy-Moore Lumber Co.*[83] held that the grantor merely protected his warranty and reserved nothing. A potential candidate for application of the *Duhig* rule exists whenever a grantor who owns less than the entire mineral estate reserves a fractional mineral or royalty interest.[84]

Much has been written regarding the *Duhig* rule, its wisdom, when it is applicable, and the theories and reasoning upon which it is founded,[85] but in Montana all this is somewhat academic as the Montana court has never had occasion to consider its adoption in this state. Although we believe the Montana Supreme Court will adopt the doctrine when faced with the issue, draftsmen should avoid causing the issue to be considered by drafting language which clearly expresses the parties' intent *Duhig* problems can be avoided by: (1) expressly subjecting the conveyance to all prior mineral and royalty reservations and conveyances; and (2) by stating that either the interest reserved is in addition to all mineral and royalty interests not owned by the grantor, or that the interest reserved includes all interests not owned by the grantor and will be reduced thereby.

B. *Royalty Burden Allocation*

A *Duhig*-like situation arises where a grantor who owns the surface and 100 per cent of the minerals, subject to an outstanding royalty interest, conveys the land by warranty deed reserving a fractional mineral interest without reference to the outstanding royalty interest. The question is the allocation of the burden of the royalty interest between the grantor and the grantee. Applying *Duhig*, the grantor's reserved mineral interest must bear the full burden of the outstanding royalty interest.[86]

This situation occurs frequently in Montana titles because of the prevalence of royalty interests reserved by counties upon disposition of land

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82. This rule is derived from the leading case of Duhig v. Peavy-Moore Lumber Co., 135 Tex. 503, 144 S.W.2d 878 (1940).

83. *Id.*

84. *See* 1 WILLIAMS & MEYERS, *supra* note 5, § 311.3.

85. *E.g.*, Ellis, *Rethinking the "Duhig" Doctrine*, 28 ROCKY MTN. MIN. L. INST. 947 (1983).

86. Selman v. Bristow, 402 S.W.2d 520, 524 (Tex.Civ.App. 1966), *writ of error refused*, 406 S.W.2d 896 (1966).

acquired by tax sales.[87] The consequences of the royalty-burden allocation can be severe. Imagine the surprise of the grantor who reserves a 50 per cent mineral interest must bear the full burden of the county royalty.

The same royalty-burden allocation problem can arise where a mineral owner (who may or may not be the surface owner) executes a mineral deed conveying a fractional mineral interest (which is less than all his interest) without mention of an outstanding royalty interest. Here again, the result is that the grantor must bear the full burden of the outstanding royalty interest.[88] Whenever there exists or possibly exists an outstanding royalty burden, the conveying or reserving instrument should explicitly state the desired allocation of the royalty burden. Usually a burden allocation in proportion to the parties' interests is desired. To simply state that the instrument or the interest conveyed or reserved is subject to outstanding royalties is not sufficient, since this presents the question of whether the interest is intended to bear the full royalty burden or only a proportionate share. Proportionate allocation of the burden of outstanding interests can be accomplished by couching the reservation or conveyance in terms of a fraction of the mineral interest owned by the grantor,[89] but reliance upon this approach is not as risk-free as an express statement of burden allocation.

C. *Fraction of What?*

Another fractional-interest problem is presented where an owner of less than 100 per cent of the land (for example, 50 per cent) executes a deed conveying "all of his right, title and interest" or and "undivided 50 per cent interest", but reserving a fractional mineral interest (again, for example, 50 per cent) in "said land", or the "the land described", or the "the land conveyed". The issue is whether the fractional mineral interest is applied to the interest in the land conveyed (i.e., 50 per cent of the minerals in an undivided 50 per cent of the land, resulting in a reserved 25 per cent mineral interest), or to the full mineral estate.[90]

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87. *See, e.g.*, Amundson v. Gordon, 134 Mont. 142, 328 P.2d 631 (1958) (burden of county royalty allocated equally between grantor and grantee on the basis of written agreement that the mineral rights were to be divided equally).

88. *See Superior Oil Co.*, 297 F.Supp. at 89-93 (mineral deed grantee held to have received a full one-half mineral interest unreduced by an outstanding 6 ¼ percent county royalty); *see also Selman*, 402 S.W.2d at 524 (grantor in deed purporting to convey ¾ of mineral estate without reference to prior royalty interest held estopped from claiming that conveyed interest proportionately burdened by the royalty).

89. *See Amundson*, 134 Mont. at 148, 328 P.2d at 633-34; *see also Superior Oil Co.*, 297 F. Supp. at 89.

90. *Compare* Hooks v. Neill., 21 S.W.2d 532 (Tex.Civ.App. 1929) (the interest reserved held to be the specified fraction of the fractional interest "conveyed") *with* King v. First Nat'l. Bank of Wichita Falls, 192 S.W.2d 260 (Tex. 1946) (the fractional interest reserved held to have related to the full

Although careful reading of deeds of this type will usually result in a conclusion that seems fairly clear, the result is often based upon how the deed is physically arranged or upon very technical construction.[91] The likelihood of error, either in drafting or interpretation, makes it unwise for a draftsman to rely upon the physical structure of the deed or the divining skills of a title examiner. Rather, the scrivener should carefully and completely describe the interest reserved (e.g., "reserving 50 per cent of all minerals in, on and under the 50 per cent undivided interest hereby conveyed, such that the grantor retains 25 per cent of the full mineral estate in the described land").

D. *Mineral Acres*

The practice of describing the quantum of mineral interest as a multiple of a "mineral acre" is popular among members of the natural resources development community. A "mineral acre" is commonly understood to consist of the equivalent of 100 per cent of the mineral estate in one acre of land,[92] and if mineral acres are used to described undivided fractional interests in a tract, the specified number of mineral acres becomes the numerator and the total acreage becomes the denominator of the fractional interest.[93] Thus, 20 mineral acres in a 40-acre tract constitutes an undivided one-half mineral interest in the tract.

While conveying a specified number of mineral acres with respect to a particular tract is an acceptable manner of conveying an undivided interest,[94] difficulties arise from the common practice of conveying or reserving fractional interest by means of a reference to *both* a specified fraction and a specified number of mineral acres.[95] If the grantor owns the specified fractional interest in all of the acreage described, and if the total acreage is actually equal to the acreage assumed, this practice does not present a problem. If, however, the grantor does not own the specified fraction in all of the described acreage, or if the tract contains more or less than the assumed number of acres, inconsistencies are inherent.[96] For example, if a grantor purports to convey a 50 per cent mineral interest, also described as 20 mineral acres in a 40 acre tract, but does not own any minerals in 10 of the acres, does the grantee acquire a 50 per cent interest or a two-thirds (20/30) interest in the 30 acres in which the grantor owns an

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interest in the land).

91. *See* 1 WILLIAMS & MEYERS, *supra* note 5, § 312.
92. 1 KUNTZ, *supra* note 8, § 16.3, at 494.
93. Krebs v. Hodgson, 274 S.2d 122, 123 (Miss. 1973).
94. *Id.*; 1 WILLIAMS & MEYERS, *supra* note 5, § 320.2.
95. *See, e.g., Superior Oil Co.*, 297 F.Supp. at 86.
96. *Id.*; 1 KUNTZ, *supra* note 8, § 16.3.

interest? Similarly, if a grantor purports to convey a 50 per cent interest in a tract assumed to contain 40 acres, and the interest conveyed is also described as 20 mineral acres, then if it is subsequently ascertained that the tract only contains 30 acres does the grantee take a 50 per cent interest or a two-thirds mineral interest in the tract?[97]

Because inconsistency is virtually certain, a fractional mineral interest should never be expressed both as a fraction and as a specified number of mineral acres. Moreover, acknowledging a title examiner's bias, we suggest for the sake of simplicity and clarity that the fractional-interest approach be used to the exclusion of the "mineral acre" concept. Fractional interests are easier to understand and apply, while title to the entire tract involved in a "mineral-acre" transaction must necessarily be examined before the effect upon any portion of the tract can be determined. Even if the scrivener is certain of the precise number of total acres and is also certain of the grantor's underlying title, only the fractional-interest approach should be used.

However, many transactions are struck on the basis of mineral acres, and in these cases a deed phrased in terms of mineral acres may best effectuate the intent of the parties.[98] When this approach is taken, the scrivener should resist the temptation to set forth the fraction which he believes results. He should also avoid reciting the assumed number of total acres, since inaccuracy in such a recital would again present an interpretation problem. If the mineral-acre approach is used, the operative instrument should include a clause which states that it is the intent to convey an undivided interest which shall be as nearly uniform as possible throughout the tract described.

E. *Royalty Fractions*

The Montana case of *Proctor v. Werk*[99] illustrates a fractional-interest issue in the royalty arena. In *Proctor*, the court examined a reservation of "six per cent of all royalties."[100] Most commentators have taken the view that there is a clear distinction between "X royalty" and X per cent of royalty," the former entitling the owner thereof to X per cent of *all* production from the land, while the latter is only X per cent of the

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97. 1 KUNTZ, *supra* note 8, § 16.3.

98. 1 WILLIAMS & MEYERS, *supra* note 5, § 320.2. While there is justification for using the mineral acre approach in mineral conveyances and reservations, the concept of "royalty acres" should be completely avoided inasmuch as,"it is not at all clear what is meant by a royalty acre." 1 KUNTZ, *supra* note 8, § 16.3. Fortunately, from our experience the "royalty acre" concept is rarely used in Montana.

99. ____Mont.____, 714 P.2d 171 (1986).

100. *Id.*

landowner's royalty reserved under a mineral lease covering the land.[101] True to its proclivity in cases of interpretation, the Montana court disagreed, holding the "X per cent of the royalty" is ambiguous as it may mean X per cent of total production. The court remanded the case for consideration of extrinsic evidence to ascertain the parties' intent.[102]

Thus, if the intent is to create a royalty of X per cent of the landowner's royalty reserved in a mineral lease covering the land, the instrument should explicitly state. The language should be expanded to provide that the specified fraction of royalty applies to the royalty under the existing lease and any future leases, thereby avoiding a potential uncertainty if the existing lease provides for one royalty rate and future leases provide for different rates.[103]

Another royalty fraction problem crops up when a specified fractional royalty is conveyed or reserved, and the grantor owns less than the full mineral fee. The question arises as to whether the royalty fraction applies to the full mineral interest, or only to the fractional interest owned by the grantor.[104] If there is any possibility that the grantor owns less than the full mineral fee, the possibility of judicial review can be negated if the controlling instrument expressly provides whether the royalty interest is proportionately reducible.

VIII. Relationships Between Conflicting Interests

The discussion thus far has addressed a number of drafting considerations with respect to defining and limiting mineral and royalty interests in terms of the substances covered and the nature and quantum of the interests. This section will focus on the legal relationships between the owners of potentially conflicting interests in the same land, and the drafting considerations with respect thereto. In each case, unless the controlling documents expressly cover the subject, the various interest

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101. Bledsoe, *supra* note 80, at 88; 1 KUNTZ, *supra* note 8, § 16.3, at 498; 2 WILLIAMS & MEYERS, *supra* note 5, §§ 327, 327.1., and 327.2.

102. *Proctor*, ____Mont. at ____, 714 P.2d at 173; *see also*, Close v. Ruegsegger's Estate, 143 Mont. 32, 386 P.2d 739 (1963) ("5 per cent of all oil royalties" treated as ambiguous and lower court's determination based upon extrinsic evidence that the parties intended a royalty of 5 per cent of all production upheld); Stokes v. Tutvet, 134 Mont. 250, 328 P.2d 1096 (1958)(involving a reservation of "two per cent (2%) of the landowner's royalty rights").

103. 2 WILLIAMS & MEYERS, *supra* note 5, § 327.2, at 90.1-90.2. Ideally, an instrument creating a royalty measured by lease landowner royalty should also deal with the eventuality of mineral development by the mineral owner without a lease, but this is probably such a rare occurrence that it may not be justifiable to interject this issue into the transaction. Since the quantum of the royalty owner's interest is dependent upon the lease negotiated by the mineral owner, this type of royalty also suggests the need for including safeguards to protect the royalty owner. *See infra* text accompanying note 125.

104. *Cf. Fry v. Farm Bureau Oil Co.*, 3 Ill.2d 94, 119 N.E.2d 749 (1954).

owners must look to statutory and case law to determine their relative rights and obligations. To the extent the controlling law is discernible, not likely to change over time and is acceptable to the parties, there is little reason to deal with the subject by agreement. If, however, the state of the law is not clear, subject to change or not acceptable, to provide certainty as well as to accommodate particular needs and desires of the parties to the transaction, the instrument creating the mineral or royalty interest should expressly set forth the relative rights and obligations as between the owner of such interest and the owners of other interests in the same land.

A. *Mineral/Surface*

Immediately upon severance of the mineral estate from the surface estate a basic conflict of interest arises. For the mineral owner to extract minerals and realize a benefit from his estate, some amount of surface-disturbing activity will be required. Surface disturbance, which can range from the total surface destruction associated with strip mining to the limited surface activity associated with oil and gas operations, will inevitably work to the detriment of the surface owner.

The right to enter upon the surface of the land and make such use of so much of the surface as is reasonably necessary for exploration, development and production of minerals is an established incident of a severed mineral estate.[105] Although this right will be implied if the controlling instrument is silent on the subject,[106] the instrument which effects the severance (or a separate agreement) can provide for relative rights different than those which would be implied.[107] The surface owner is not entitled to compensation for damages resulting from the mineral owner's exercise of his right to use of the surface,[108] absent an express provision to this effect in the conveyance or reservation severing the mineral estate,[109] or a statute dealing with the subject.[110] The mineral owner is, however, liable for damages to the extent his surface use is unreasonable, excessive

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105. *Hurley*, 153 Mont. at 202, 455 P.2d at 323; McDonald v. Unirex, Inc., ____Mont.____, 718 P.2d 316, 317 (1986).

106. *Western Energy Co.*, 195 Mont. at 209, 635 P.2d at 1301.

107. *Cf.* Sellars v. Ohio Valley Trust Co., Inc. 248 S.W.2d 897, 898 (Ky. 1952) (construing a deed which provided that no surface rights of privilege were conveyed); Mobil Oil Corp. v. Brennan, 385 F.2d 951, 952 (5th Cir. 1967) (mineral deed provided for the burial of pipelines and non-interference with grazing).

108. Northern Cheyenne Tribe v. Hollowbreast, 349 F.Supp. 1302, 1310 (D.Mont. 1972), *rev'd on other grounds sub nom*, Norther Cheyenne Tribe v. Northern Cheyenne Defandant Class of Allottees, Heirs, Devisees, 505 F2d 268 (9th Cir. 1974), *rev'd on other grounds*, 425 U.S. 649 (1976); *see also* Norum v. Queen City Oil Co., 81 Mont. 527, 539, 264 P. 122, 125 (1928).

109. *See, e.g., Western Energy Co.*, 195 Mont. at 208, 635 P.2d at 1301.

110. *See, e.g.*, MONT CODE ANN. §§ 82-10-501 through -511 (1987) (providing for the payment of compensation to the surface owner for damages caused by oil and gas operations).

or unnecessary, or if the damages result from negligent operations.[111] The mineral owner's right of surface use does not include the right to use of the surface in connection with mineral development and production from other lands, and the mineral owner will be liable in the event of such use.[112]

The trend, both legislative and judicial, seems to afford surface owners increased protection from surface-disturbing mineral exploration and development activities. Although not yet adopted in Montana, the doctrines of "alternative means" and "accommodation" will probably find favor with the Montana courts. The doctrine of alternative means requires the mineral owner to take an operational approach which is less disruptive to the surface owner if such approach is reasonable.[113] The doctrine of accommodation balances the correlative rights of the mineral and surface owner to establish their relative rights and obligations.[114] The surface owner is also protected by the rule of subjacent support, which entitles him to the physical support provided by underlying mineral strata.[115]

The common law rule stated above regarding the absence of liability to the mineral developer for surface damages has been altered with respect to oil and gas operations by the Montana Surface Owner Damage and Disruption Compensation Act of 1981.[116] This Act, which applies to oil and gas operations only, requires notice to the surface owner prior to commencement of operations; obligates the oil and gas operator to compensate the surface owner for loss of agricultural production and income, lost land value and lost value of improvements; and provides a mechanism by which the surface owner can initiate surface damage settlement negotiations.[117]

Although the general legal relationship between the surface owner and a severed mineral interest owner is reasonably well established, there is much room for contractual interface, particularly from the surface owner's point of view. For example, even though the Montana Surface Owner Damage and Disruption Compensation Act provides for compensation to the surface owner for damages in the oil and gas context, the surface owner may wish to include damage-compensation provisions with respect to *all* minerals, and even enhance the protection afforded by the Act. In some circumstances, it might be appropriate to provide detailed damage-compensation provisions including the relevant measure of damages, the

111. *See Hurley*, 153 Mont. at 203, 455 P.2d at 323; *Norem*, 81 Mont at 539-40, 264 P. at 125.

112. Russell v. Texas Co., 238 F.2d 636, 642 (9th Cir. 1956), *cert. denied*, 354 U.S. 938 (1957).

113. *See* Getty oil Co. v Jones, 470 S.W. 2d 618, 621 (Tex. 1971).

114. *See* Humble Oil & Ref. Co. v. West, 508 S.W.2d 812, 815 (Tex. 1974).

115. 6 AM. L. OF MINING § 200.02[1][b] (1987); *compare Western Energy Co.*, 195 Mont. at 208, 635 P.2d at 1301 (strip mining within contemplation of parties at the time of mineral severance) *with* Smith v. Moore, 172 Colo. 440, 444, 474 P.2d 794, 796 (1970) (strip mining not contemplated).

116. MONT. CODE ANN. §§ 82-10-501 through -511 (1987).

117. *Id.* §§ 82-10-502, -503, -504, -506 and -507 (1987).

damage elements to be considered, and procedures for determining damages.

The surface owner may wish to restrict or even preclude the mineral owner's surface use rights. Rather than relying upon the mineral owner's discretion as to what is reasonable and necessary, the surface owner may want to specifically detail the extent of the mineral owner's rights. On the other hand, the mineral owner may wish to expand the rights otherwise held. For example, the right to use the surface for mineral development in connection with adjacent lands may be needed.

Although the severance of the mineral estate from the surface estate is commonplace, in most cases the relationship between the owners of each is accorded little drafting attention. Yet, this is an extremely explosive relationship, and one that invariable breeds contention. Consider the situation where a party purchases the surface estate, subject to a reservation of all minerals, only to find some years later that the surface estate is about to be destroyed completely by a strip mine.[118] In view of the sensitivity of this relationship, the scrivener must determine whether the parties are satisfied with the relationship established by law, or whether express provisions governing this relationship are appropriate for the transactions at hand.

B. *Life Tenant/Remainderman*

The creation of life estates involving mineral interests, whether severed from the surface estate or not, gives rise to conflicting interests as mineral production by the life tenant depletes the estate to which the remainderman will succeed. A basic issue to be addressed is whether the life tenant can, without the consent of the remainderman and absent express language in the creating instrument, develop and produce minerals or grant the right to develop and produce minerals to a mineral lessee. Generally, absent the existence of an "open" mine or well, the life tenant does not have the right to develop and produce minerals, either personally or through a lessee, as such would constitute waste.[119]

In contrast, the Montana Supreme Court apparantly will readily find within the creating instrument a grant of the right to develop and produce

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118. *See, e.g.*, Western Energy Co. v. Genie Land Co., 195 Mont. 202, 635 P.2d 1297 (1981). The Montana Legislature intervened in this relationship by requiring surface owner consent prior to the issuance of any coal strip mining permit. MONT. CODE ANN. § 82-4-224 (1987). However, in subsequent litigation the legislation was declared unconstitutional. Western Energy Co. v. Genie Land Co., ____Mont.____, 737 P.2d 478, 484 (1987). Of course, at the time of the mineral severance, the parties could have effectively agreed that surface owner consent was required prior to strip mining.

119. Welborn v. Tidewater Associated Oil Co., 217 F.2d 509, 510 (10th Cir. 1954); 1 SUMMERS, THE LAW OF OIL AND GAS § 32 (1954). The extent to which the general life tenant/remainderman rules apply to severed mineral interests is subject to question. 1 KUNTZ, *supra* note 8, § 8.6.

minerals. In *Danielson v. Danielson*,[120] the court held that the life tenant had the right to produce and sell gravel where the instrument creating his estate granted him, "the right to use [the land], as he may deem fit, and to receive the income and proceeds" from the land.[121]

However, a draftsman would be unwise to rely upon a blanket application of *Danielson*. This issue should be resolved in the instrument creating the life estate by either expressly granting or denying the life tenant the right to develop and produce minerals and to execute mineral leases. If the right is granted, it should explicitly include the right to grant a lease which will survive the life tenancy, since without this right a mineral lessee would unlikely invest the funds necessary to develop the minerals if his rights are subject to termination at any time upon the death of the life tenant.[122]

Assuming that the life tenant and remainderman have joined in a mineral lease, or mineral development and production occurs on some other basis, the next issue concerns the rights of the parties to bonuses, rentals and royalty payments. Again, absent an "open" mine or well or express provisions to the contrary, the general rule is that the life tenant is entitled to rentals, but only the interest earned on bonuses and royalties, with the principal thereof passing to the remainderman upon the termination of the life estate.[123] To avoid disputes, the instrument creating the life estate should detail the relative rights of the parties to the proceeds of mineral development and leasing.

C. *Executive/Non-Executive*

The "executive" is the owner of the exclusive right to execute mineral leases which right is one of the elements of the mineral estate.[124] For purposes of this article, the "non-executive" is assumed to be the owner of a royalty or non-executive mineral interest as to which the realization of a benefit is in some manner dependent upon action of the "executive". The creation of an executive/non-executive relationship gives rise to various concerns.

For example, consider the creation of a royalty interest which is measured in terms of a fraction of whatever landowner royalty is reserved in any existing or future mineral lease.[125] Accordingly, the extent of the

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120. 172 Mont. 55, 560 P.2d 893 (1977).

121. *Id.* at 56, 560 P.2d at 894-95.

122. *Cf.* Doverspike v. Chambers, 357 Pa. Super. 539, 516 A.2d 392 (1986) (involving the issue of whether a lease executed by a life tenant survives his death).

123. R. SULLIVAN, HANDBOOK OF OIL AND GAS LAW § 25 (1955); 1 KUNTZ, *supra* note 8, § 8.2.

124. *Stokes*, 134 Mont. at 256, 328 P.2d at 1100.

125. *See supra* text accompanying note 103.

royalty owner/non-executive's interest is directly dependent upon the lease royalty negotiated by the executive. More importantly, whether the royalty owner will realize *any* benefit from his interest is dependent upon whether the executive grants a mineral lease or proceeds with mineral development himself. Similar interdependent relationships exist between the executive and the non-executive mineral owner.

Aside from negotiated contractual provisions, does the executive owe any duty to the non-executive with respect to exercise of the executive right? Although Montana has no cases on point and other jurisdictions are not consistent, most courts that have dealt with the issue impose some sort of a rather loosely-defined duty on the executive.[126] Courts have struggled with such problems as the duty of the executive to develop the minerals and to protect the non-executive against drainage,[127] the duty of the executive to lease,[128] whether the executive breaches his duty by self-dealing,[129] and whether the executive breached his duty by negotiating for himself an additional overriding royalty and an additional cash payment.[130]

This is an instance where the uncertainty in the law suggests the need for express provisions either to protect the non-executive from the actions or inactions of the executive, or to absolve the executive from liability or a combination of both. Such provisions in the creating document can be as simple as establishing the existence of a duty and a general statement of its nature, e.g., a fiduciary duty, a duty of utmost fair dealing and diligence, or a duty of ordinary care. At the other end of the spectrum, it may be appropriate to include detailed provisions regarding the exercise of the executive right, such as imposing obligations to protect against drainage and to lease in a timely manner and fixing minimum requirements with respect to lease royalty, bonuses and rentals.

Whatever the final conclusions may be, the draftsman should be aware of the potential for conflicts and diverging interests between the executive and non-executive, and consideration should be given to setting

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126. *See* 2 WILLIAMS & MEYERS, *supra* note 5, § 339.2; *see also* Smith, *Implications of a Fiduciary Standard of Conduct for the Holder of the Executive Right*, 64 TEX. L. REV. 371 (1985), *reprinted in* 24 PUB. LAND & RES. L. DIG. 10 (1987)

127. Pinchback v. Gulf Oil Corp., 242 S.W.2d 242 (Tex.Civ.App. 1951).

128. Federal Land Bank of Houston v. United States, 168 F.Supp. 788, 791 (Ct.Cl. 1958) (breach of duty of "utmost fair dealing and diligence" where executive failed to timely exercise its leasing power).

129. Manges v. Guerra, 673 S.W.2d 180, 183-84 (Tex. 1984) (breach of "fiduciary duty" of "utmost fair dealing" where executive executed lease to himself).

130. Portwood v. Buckalew, 521 S.W.2d 904, 914-18 (Tex.Civ.App. 1975) (breach of duty of "utmost fairness" where executives took royalties and cash payments in addition to the benefits shared with the non-executive); *see also* Schroeder v. Schroeder, 133 Ill.App.3d 740, 747-51, 479 N.E.2d 391, 398-99 (1985) (breach of duty based on an "ordinary and prudent landowner" test where executive took an additional royalty for himself).

forth guidelines to control this relationship.

D. *Multiple-Mineral Development*

Concurrent, but incompatible, development and extraction of dissimilar mineral substances or various mineral strata owned by different parties is rife with legal conflicts. The classic example of such a conflict is the competing interests of oil and gas operations and coal mining.[131]

Unlike the well-established rules regarding the conflict between the dominant mineral estate and the subservient surface estate,[132] the law with respect to multi-mineral development conflicts between co-equal estates is not well defined, particularly in states such as Montana where there is no judicial precedent.[133] Various theories traditionally have been utilized to resolve these conflicts, including finding implied rights of access and removal[134] and finding a way of necessity.[135] More recently, the courts have displayed a greater degree of sophistication in approaching such problems, turning to doctrines such as that of alternative means[136] and the doctrine of accommodation.[137] Even the rudimentary concept of first-in-time, first-in-right has been considered in this area.[138]

Although it is undoubtedly impractical to resolve potential multiple-mineral development conflicts in every transaction which results in diverse ownership of different mineral substances or strata, where such conflict is likely it is important to address these issues rather than to leave them to the vagaries of resolution by litigation. Provisions dealing with mineral development must be tailored to meet the particular situation, but should include a resolution of the basic issues: (a) the right of access through other mineral deposits; (b) the relative right to engage in conflicting or interfering operations: (c) priority of right where operations are mutually exclusive; (d) required accommodations; (e) precautions to be employed; and (f) the entitlement to damages for interference, precluded operations, lost reserves and incremental costs of concurrent operations.[139]

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131. *See, e.g.*, Chartiers Block Coal Co. v. Mellon, 152 Pa. 286, 25 A. 597 (1893).

132. *See supra* text accompanying note 105.

133. *See* Lear, *Multiple-Mineral Development Conflicts: An Armageddon in Simultaneous Minerals Operations?*, 28 ROCKY MTN. MIN. L. INST. 79, 199-209 (1982); *see also* Kramer, *Conflicts Between the Exploitation of Lignite and Oil and Gas: The Case for Reciprocal Accommodation*, 21 HOUSTON L. REV. 49 (1984), *reprinted in* 22 PUB. LAND & RES. L. DIG. 10 (1985).

134. Chartiers Block Coal Co. v. Mellon, 152 Pa. 286, 25 A. 597 (1893).

135. Pyramid Coal Corp. V. Pratt, 229 Ind. 648, 651-53, 99 N.E.2d 427, 430 (1951).

136. *Getty Oil Co.*, 470 S.W.2d at 621; *see supra* text accompanying note 113.

137. *Humble Oil & Refining Co.*, 508 S.W.2d at 815; *see supra* text accompanying note 114.

138. *See* Lear, *supra* note 133, at 209-10; *see also* 6 AM. L. OF MINING § 200.04[2][d][i] (1987).

139. *See* 6 AM.L. OF MINING § 200.04[2][d][ii] (1987).

E. *Cotenants*

Where the mineral estate is divided into undivided fractional interests, the several mineral owners are cotenants.[140] Each mineral cotenant, at least in Montana, has the non-exclusive right to enter the premises and extract minerals without being guilty of waste.[141] Moreover, each mineral cotenant may separately lease his mineral interest and confer on the lessee his right to extract minerals.[142] A cotenant who extracts minerals may charge against the proceeds the reasonable and necessary expenses of extraction and marketing but must account to his cotenants for their share of the net profits.[143]

The fundamental legal relationship between cotenants is fairly well established and defined. Accordingly, this subject need not be covered in instruments creating undivided mineral interests so long as the established case law and statutes define a relationship acceptable to the prospective mineral cotenants. However, there may be circumstances where the relationship provided by law is not acceptable.

The rule that each mineral cotenant is entitled to proceed with mineral development without the consent of other cotenants precludes one cotenant from absolutely blocking mineral development. However, the bare right to proceed on the basis of a fractional mineral interest is not often economically adequate.[144] In view of the high cost of financing mineral exploration and development and the significant risks involved, fractional mineral interest owners are understandably disinclined to proceed with mineral development on their own when they will be obligated to pay over a share of the profit to cotenants who made no investment in capital and who were subjected to no risks.

The law provides the device of involuntary partition as one potential solution to this problem.[145] In the oil and gas context, this problem has been addressed in some states by pooling statutes which provide for the imposition of penalties upon owners who refuse to join in the risk of development, or provide other measures which reward the developing

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140. *Amundson*, 134 Mont. at 149, 328 P.2d at 634.

141. MONT. CODE ANN. §§ 70-1-311 and 70-19-202 (1987); *Hochsprung v. Stevenson*, 82 Mont. 222, 237-38, 266 P. 406, 409 (1928). The Montana rule is in accord with the majority of states, while the minority rule is that production of minerals by one cotenant constitutes actionable waste. 1 KUNTZ, *supra* note 8, §§ 5.3 and 5.4.

142. *Amundson*, 134 Mont. at 149, 328 P.2d at 634; *Hochsprung*, 82 Mont. at 238, 266 P. at 409.

143. *Marias River Syndicate*, 98 Mont. at 265, 38 P.2d at 602; MONT. CODE ANN. § 70-19-202 (1987); *see also* MONT. CODE ANN. § 82-11-202 (1987) (provides for forced pooling of undivided interests within an oil or gas spacing unit, the allocation of costs and the division of net proceeds).

144. 4 AM. L. OF MINING § 131.03[2] (1987).

145. 2 WILLIAMS & MEYERS, *supra* note 5, § 506.

owner for incurring the risk of development.[146] Although the 1985 Montana Legislature passed provisions which provide for non-consent penalties,[147] the question of whether this statute will be effective to impose non-consent penalties upon non-joining co-owners is beyond the scope of this article. In any event, pooling statutes apply only to oil and gas operations.

The frustration of mineral development which may result from the fractionalization of the mineral estate into many undivided interests is undoubtedly one of the reasons for the development of the concept of the non-executive mineral interest. The creation of a non-executive mineral interest rather than an undivided, fully-participating mineral interest leaves the executive and development rights in the entire mineral estate vested in one person. A viable alternative available when the cotenancy is created is to include provisions designed to avoid the problems of multiple ownership, such as forced joinder in development, nonconsent penalties, or forfeiture for refusal to join in a proposed operation.

IX. CONCLUSION

This article is *not* a comprehensive catalog of all problems associated with the creation of severed mineral and royalty interests. It is hoped, however, that the points discussed will provide scriveners with food for thought, and a flavor for the kinds of concerns which should receive attention in their drafting efforts. Mineral and royalty conveyancing requires not only word skills, but also an understanding of the nature of the interests involved and the results desired by the parties.

Continued mineral development in Montana will undoubtedly subject many conveyances involving mineral and royalty interests to intense scrutiny—first by title examiners, and then, unfortunately, perhaps by the courts. This, coupled with the tendency of the Montana Supreme Court to seize upon any uncertainty, however slight, to declare the draftsman's product ambiguous, and then resort to extrinsic evidence to ascertain intent,[148] makes it imperative that the draftsman exercise extreme care and take the time to effect the intent of the parties with clear and concise language.

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146. *See, e.g.*, N.M. STAT. ANN. § 70-2-17 (1987).

147. 1985 Mont. Laws 694, (codified at MONT. CODE ANN. § 82-11-202 (1987)).

148. *See, e.g., Adams*, 182 Mont at 517, 597 P.2d at 1144; *Proctor*, ____Mont. at____, 714, P.2d at 173; *Crawford*, 137 Mont. at 144-45, 351 P.2d at 225.