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School of Law

4-1972

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Recommended Citation

Clegg, Oliver M., "Review of Recent Court Decisions Affecting the Oil and Gas Industry" (1972). *Annual of the Arkansas Natural Resources Law Institute.* Paper 6.
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11th ANNUAL ARKANSAS OIL AND GAS INSTITUTE
ARKANSAS BAR ASSOCIATION
APRIL 13-14, 1972

Majestic Hotel
Hot Springs, Arkansas

"REVIEW OF RECENT COURT DECISIONS AFFECTING THE OIL AND GAS INDUSTRY"

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# REVIEW OF RECENT COURT DECISIONS
# AFFECTING THE OIL AND GAS INDUSTRY

I have revised the subject topic as shown in the program to add the word "recent", so that it reads, "Review of Recent Court Decisions Affecting the Oil and Gas Industry." The title shown in the program is somewhat open-ended and reminds me of a recent "decision" of Judge George Rose Smith of our Supreme Court. The litigation began as a simple suit in ejectment, but the defendant entered a very novel and sweeping defense, citing an act of the previous Legislature providing: "All laws and parts of laws are hereby repealed." As you know, it is customary for legislative acts to include a repealing clause in the standard language: "All laws or parts of laws in conflict herewith are hereby repealed." Apparently, in its haste to adjourn or to do something else, the Legislature in one instance had omitted the words "in conflict herewith." Acceding to the recent clamor that Courts stop usurping Legislatures, Mr. Justice Smith held that the language of the statute was plain; that the Court was bound to carry out the legislative intent; and that its effect was simply to repeal all of the statutory and case law in the State of Arkansas. Needless to say, there was great consternation among the bench and bar until someone remembered that the day the opinion was rendered was April 1. Then someone else, having some knowledge of French, recognized that the style of the case, *"Poisson v. D'Avril"*, means "Fish of April", or, in our idiom, April Fool!

In looking back through past volumes of the Institute proceedings, for which we are all deeply indebted to Murphy Oil Corporation, I notice that the topic, "Recent Developments in Oil and Gas Law", has become an annual one, and in fact, at one Institute, there were two talks having that identical subject, back to back.

The format of this presentation generally has assumed a reference to the recent Arkansas decisions and then some comments on recent decisions from other jurisdictions.

During 1971, the Arkansas Supreme Court decided only one case of special interest in the mineral field, *Helms v. Vaughn*, 250 Ark. 828, 457 S.W.2d 399. Two brothers had acquired a royalty interest in 1947. On December 27, 1963, one of the partners executed an instrument styled "Release", by which he purported to "release, remise, relinquish, and surrender all of his right, title and interest in" the royalty, etc. Suit was filed by the landowners claiming that the interest released vested in them. The Court held, however, that since there was no grantee named in the deed, it was void for want of a necessary party and further that there was no abandonment, since minerals in place constitute real property and can only be relinquished in circumstances of estoppel or adverse possession. Since there was no evidence of any reliance by the land owners upon the alleged abandonment so as to create an estoppel nor evidence of adverse possession, the Court found that the deed was a nullity and title was quieted in the defendants.

While the opinion does not so state, it is possible that the mineral owner executed the instrument in question for the purpose of

establishing a tax loss and that when the minerals later became valuable, he changed his mind about disposing of them. However, it is not the tax consequences that interest us at the moment, but rather the statement by the Court of the technical requirements of conveyancing, "including the necessity for a grantee in a deed for it to be operative and the basic rule that title to minerals in place cannot be lost by abandonment, except where the elements of estoppel or the statute of limitations are present.

The other Arkansas case of interest decided in 1971 is *Mining Corporation of Arkansas v. International Paper Company*, 324 F.Supp. 705. The case was tried to Senior District Judge John E. Miller, surely one of the outstanding jurists in all of the history of the State of Arkansas.

The question was whether cinnabar, or mercury, was included in a 1911 reservation of "all minerals, coal, oil, or gas." The mother case in this field is *Missouri Pacific Railroad Company v. Strohacker*, 202 Ark. 645, 152 S.W.2d 557. For a complete discussion of the *Strohacker* case and the subsequent decisions, see "Strohacker Revisited - a Problem in Mineral Conveyancing", 1st Annual Arkansas Oil and Gas Institute (1962). Briefly, the question presented in the *Strohacker* line of cases is what specific minerals are included in the general term "minerals."

Judge Miller aptly summed up the ruling of the cases that the term "minerals" only includes "those minerals known to exist in the general area of the land embraced in the deed at that time. The factual question of whether cinnabar was a mineral known to be present in Clark County in 1911 was decided upon governmental reports, clearly proving that cinnabar, or mercury, was first discovered in Arkansas in about 1930 or 1931

Because of the *Strohacker* rule, which oftentimes defeats the real intent of the parties, a broad form of reservation has been devised and is in limited use in South Arkansas. While it is not perfect and should always be used in the light of each given situation, it is usually in the following language:

> "The grantors except from this conveyance and reserve unto themselves, their heirs and assigns, all of the oil, gas, distillate, condensate, iron, bauxite, copper, zinc, tin, barite, gold, silver, silica, salt water, and all other minerals, whether like or unlike those described, including all substances which are not now, but which may in the future be classified as minerals, together with the right of ingress and egress for the purpose of mining, exploring for, producing, saving, transporting, and marketing any of the aforesaid minerals."

The *Strohacker* question has arisen in South Arkansas in recent years in connection with the production of bromine from salt water. For a discussion of those problems, see "Legal Aspects Relative to Bromine," 8th Annual Oil & Gas Institute, 1969.

A variation of the *Strohacker* problem was presented last year to the Supreme Court of Texas in *Acker v. Guinn*. Involved was a 1941 deed conveying "an undivided one-half interest in and to all of the oil, gas and other minerals in and under and that may be produced from" a tract in Cherokee County, Texas. The question was whether the grant included an interest in a surface deposit of iron ore. The Court, in effect, rejected the reasoning of the *Strohacker* case and approved the reasoning of Professor Kuntz in his article, "The Law Relating to Oil and Gas in Wyoming", 3 Wyom. Law. Rev. 107. Professor Kuntz had suggested that the courts were mistakenly attempting to discover and give effect to an intention to include or exclude a specific substance from the grant or

reservation. Rather, he said:

> "The intention sought should be the *general intent*, rather than any supposed, but unexpressed, *specific intent*, and, further, that general intent should be arrived at, not by defining and re-defining the terms used, but by considering the *purposes* of the grant or reservation in terms of manner of enjoyment intended in the ensuing interests."

He then sets out the general approach to be made:

> "When a general grant or reservation is made of all minerals without qualifying language, it should be reasonably assumed that the parties intended to sever the entire mineral estate from the surface estate, leaving the owner of each with definite incidence of ownership enjoyable in distinctly different manners. The manner of enjoyment of the mineral estate is through extraction of valuable substances, and the enjoyment of the surface is through the retention of such substances as are necessary for the use of the surface, and these respective modes of enjoyment must be considered in arriving at the proper subject matter for each estate."

The Texas Court, following Professor Kuntz's reasoning, concluded:

> "Unless the contrary intention is affirmatively and fairly expressed, therefore, a grant or reservation of 'minerals' or 'mineral rights' should not be construed to include a substance that must be removed by methods that will, in effect, consume or deplete the surface estate."

The Supreme Court of Texas referred to *Carson v. Missouri Pacific Railroad Co.*, 212 Ark. 963, 209 S.W.2d 97, where the Arkansas Court held that bauxite was not included in a 1892 reservation of "all coal and mineral deposits", because "(1) bauxite is a clay formation containing alumina in small particles; (2) its existence was not known at the time the instrument was executed; and (3) the mining of bauxite is generally by the open pit method, which would destroy the value of the estate."

It would therefore seem that Arkansas has, in effect, recognized both rules and the question now arises as to what approach the Supreme Court will take when next confronted with this question. The Court's reluctance to disturb what it sometimes calls "Rules of Property" may be a deterent, but it would certainly seem that the better rule is that advanced by Professor Kuntz.

One of the most interesting decisions of 1971 was *Jolly v. Wilson*, 278 Pac.2d 886. In that Oklahoma case the reservation in a deed was:

> "However, there is reserved and excepted from this conveyance, one-half of one-eighth of all minerals in and under said land, the same being reserved and excepted, and said royalty is nonparticipating in the lease or lease rentals."

The Court applied the rule that where a reservation contained characteristics of both a mineral and a royalty interest, it will be construed to reserve that interest whose characteristics are more clearly described, and, it said, the language "minerals in and under" the land clearly indicated a mineral interest and overcame the provision "said royalty is nonparticipating in the lease or delay rentals", particularly where there was no outstanding oil and gas lease. The Court adopted the approach that the elements of ownership of minerals as opposed to the elements of ownership

of royalty furnish a key to the proper construction of the language and thus the intent of the parties. As a preliminary to this discussion the court pointed out a summary of factors to be considered in distinguishing whether a mineral or royalty interest reservation is made from 9 Okla. Law Rev. 139 as follows:

> "(1) If the interest conveyed or retained is of the oil and gas in and under the land, a mineral interest is indicated. On the other hand, if the interest conveyed is in oil and gas to be produced, a royalty interest may be the result.
>
> "(2) Who has the right to grant leases, and to receive bonuses and rentals? If it is the grantee of the interest, a mineral interest is created. If not, a royalty or nonparticipating mineral interest may be the result.
>
> "(3) If the right of ingress and egress and of exploration is granted, the interest conveyed is mineral not royalty.
>
> "(4) If there is an oil and gas lease in existence at the time the deed is made, the word 'royalty' when used to describe the interest reserved or conveyed, is usually interpreted to mean royalty in the restricted sense as a share in production only; but, in the absence of an existing lease, 'royalty' is likely to be interpreted in its loose, broad sense to mean a mineral interest.
>
> "(5) If the interest conveyed or retained is 'royalty' in its restricted sense, the fractional designation of the quantum of interest usually refers to that fractional part of the gross production. If the interest is 'mineral' the fractional designation of the quantum conveyed or retained usually entitled the grantee to only that fractional part of the lessor's share of production."

I have copied the summary because it may be of some assistance as a guide to whether a particular reservation or grant is of minerals or royalty.

The Oklahoma Court placed great emphasis upon the fact that the reservation used the language "minerals in and under the land." That language, clearly indicating a mineral estate, was sufficient to overcome what the Court said was ambiguous language, "said royalty is

nonparticipating in the lease or lease rentals." The Court said that the use of the term "royalty" was weakened by the fact that the land was not and never had been under lease. It disposed of the statement that the interest was nonparticipating in "the lease or lease rentals" by saying that the parties could have meant that the owner of the interest would not participate in the lease bonus and lease rentals without regard to the executive right or the necessity to execute the lease.

I am inclined to disagree with the holding of the Court. The language "minerals in and under said lands" is more often used as a formal, legalistic expression. It seems to me that the real intent of the parties is better arrived at by looking at the specific and unusual language which they use, rather than legal formalities. To me, one of the most significant keys to the intent of the parties is the fact that they reserved "one-half of one-eighth." This is clearly a reference to the usual one-eighth royalty provided in leases. If the parties had merely intended to reserve a one-sixteenth of the oil, gas and minerals in place, as the Court held, they would normally have expressed it in one fraction, "one-sixteenth", rather than expressing it in a double fraction. Cf. *Longino v. Machen* (1950) 217 Ark. 641, 232 S.W.2d 826.

Furthermore, the use of the term "said royalty" is an express description by the parties of the interest with which they are dealing. The word "nonparticipating", however hazy its origins may be, has come to have a recognized meaning, and is certainly consistent with the use of the word "royalty." See "Non-Participating Royalty", 5th Annual Ark. Oil & Gas Institute (1966).

While it is technically true that the executive rights may be separated from rights to participate in bonus and rentals, as a practical matter, this is not a desirable situation. If, as the Court holds, the owner of this reserved interest is not entitled to participate in the lease bonus, but is required to sign the lease, those of you who have had some experience in getting leases signed by parties who will not receive any money will immediately recognize the practical problem. Thus, the Oklahoma Court held that instead of being entitled to one-half of the one-eighth royalty under any future lease, "nonparticipating", the grantor had a one-sixteenth mineral interest which, when leased, would entitle him to 1/128 of the production as a royalty, rather than 1/16, without participation in the bonus or rentals, but with the necessity for executing the lease. In other words, if the interest owner is not entitled to participate in the lease bonus, it is inconsistent to say that he is a necessary party to the lease; and if he is not a necessary party to the lease, then it is inconsistent to say that the interest he owns is a mineral interest. It is submitted that the decision of the Court is based upon the use of technical rules of construction, rather than special language the parties purposely used to describe the interest they were attempting to create.

One other case decided in 1971 should be mentioned, it also being a decision of the Oklahoma Supreme Court. In *Beaton v. Pure Oil Co.*, 483 Pac.2d 1145, four grantors who collectively owned the full mineral fee made a deed containing a warranty clause which undertook to convey "an undivided ___________ interest" in forty acres. The lower Court held

that the deed conveyed the entire mineral interest of the grantors. The Court of Appeals held the existence of the word "undivided" suggested something less than all, and that the blank created an ambiguity that could be resolved by extrinsic, parol evidence and that since such evidence could not be introduced because of the Statute of Frauds, the deed was therefore void. The Supreme Court affirmed the first decision, holding that the deed conveyed all of the interest of the grantors, relying heavily upon an Oklahoma statute, 16 O.S. 1961, §19, that a warranty deed conveyed to the grantee the entire interest of the grantor. While Arkansas does not have a statute identical to that of Oklahoma, there has long been case law to the same effect. In *Patterson v. Miller*, 154 Ark. 124, 241 S.W. 875, the Arkansas Court said:

> "There is a presumption, of course, that a grantor intends to convey his entire interest by his deed, and such is the effect of the deed which does not limit the interest conveyed."

A harder case, of course, would be made if the grantor owned less than the full mineral fee and purported to convey "an undivided ________ interest" in oil, gas and minerals. That, of course, differs from a deed conveying "my undivided _______interest." I have not found any direct authority, but I would be inclined to think that, particularly if a printed form were used, and the language was "an undivided ________ interest", the Court should treat that as ambiguous or imcomplete and permit the introduction of parol testimony to determine what interest was intended to be conveyed. Usually, of course, there are other keys in the instrument, such as the common expression of an intention to convey

a certain number of mineral or royalty acres.

I appreciate the honor of this traditional task of mentioning some of the recent decisions, and I look forward with you to another instructive and enjoyable Institute.