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## DRAFTING CONVEYANCES OF MINERAL AND ROYALTY INTERESTS

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When I first gave consideration to preparing material in the general area of the mechanics of drafting, and the differences between reservations and assignments of mineral interests and royalty interests, it appeared to me that there was much that could be said about the subject. However, judgment as to the particular areas of this branch of the law to be discussed here had to be exercised to attempt to make an half hour of discussion worthwhile.

In the process of continually reviewing new cases in the oil and gas field that turn on problems of construing instruments transferring mineral interests or royalty interests, I am always disturbed by the amount of litigation that is continually arising because of disagreement as to the interpretation of words and the resulting resort to various means of ascertaining the intention of the parties. It is true that many current disputes are based upon instruments that were drafted years ago. This holds the hope that parties currently concerned with drafting instruments do have guideposts for their efforts, but such a hope has not been fully realized as evidenced by recent cases involving draftsmen's products of recent vintage. In looking for the underlying causes of litigation concerning transfers of oil and gas interests, there is no question but what the draftsmen of instruments often fail to state the intention of the parties in an unambiguous form. However, it is also true, particularly in jurisdictions without a substantial number of decisions in oil and gas, that courts have found ambiguity in situations in which many would agree that it did not exist. Time does not permit discussion of the many factors which have led to differing results in interpretation, and so hereafter we will look at the subject from the standpoint of minimum and basic principles involved in the transfer of mineral and royalty interests.

It seems to me that before anyone should endeavor to execute a transfer of any type of mineral or royalty interest in oil and gas, he should understand the nature of the beast and the parts into which it may be carved to serve the purposes of oil and gas operations, as well as the names and labels which courts have accepted as describing a certain part. Further, the draftsman should also clearly ascertain what the parties think they are transferring. A recent Montana decision is typical of the latter problem. In *Voyta v. Clonts*, (1958, 328 P.2d 655, 9 O & G R 522) a contract for sale provided for retention by the seller of a percentage of "landowner's mineral rights." At trial of the case both parties admitted that they interpreted this provision as merely referring to the

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division of the *royalty* vested in the landowner under the existing oil and gas lease. It is perhaps easy to appreciate how a landowner may think of the receipt of royalty as the extent of his mineral interest, since he knows that what he receives is royalty from his minerals under lease.

Let us briefly examine the ownership in fee simple of our favorite hypothetical farm, Blackacre. If there are no prior reservations of minerals in landowner's chain of title to Blackacre, we can say that Landowner has the following rights to oil and gas or other minerals in his land, which are summarized by saying that he is the mineral interest owner.

1. He has certain rights which we can call "executive rights." That is, he has control of the minerals. He can explore for them, he can develop and produce the minerals, or he can execute a lease transferring these specific rights.
2. He also possesses certain non-executive rights, which are rights that are normally considered incidents of the mineral interest and which follow transfers of the mineral interest. These are the right to royalty, bonus, and delay rental.

The Supreme Court of Wyoming has recognized that the mineral interest may be severed from the surface and constitutes a severed mineral estate which is "land." This Landowner may sever the mineral estate by grant or by reservation, and it would further appear that inasmuch as this is an estate, the duration of such an estate would be in terms of a fee simple unless otherwise limited. Inasmuch as the mineral interest is an estate and land, if Landowner desires to convey his mineral interest, he should use an instrument which measures up to requirements for a transfer of land. Such an instrument would be a deed, or "mineral deed." The deed may convey with warranties of title, or it may be by quitclaim. While I have indicated a label here (deed or mineral deed) it must be kept in mind that courts have not appeared to be overly concerned with the particular type of instrument utilized to transfer mineral interests, for you can find instruments labeled as "Royalty Assignments" which have been interpreted as transfers of mineral interests. Thus, while I cannot say that it is impossible to transfer mineral interests by an instrument which purports to "assign, sell and transfer" and does not employ words of a statutory form of deed or common law words of grant or bargain and sale, I would say that the draftsman should rely upon principles of conveyancing in preparing a transfer of the mineral interest.

If Landowner decides to quitclaim or warrant his mineral interest, the next critical area is the specific words used to describe the mineral interest. If it is intended to accomplish a complete severance of the mineral estate, the description of the property could be: "all oil, gas, and other minerals in and under Blackacre." Note that I did specifically

mention only oil and gas. While I believe that the majority of jurisdictions have treated oil and gas as being mineral, we have not had the issue specifically litigated in this state. It is also to be pointed out that courts are not in agreement as to the interpretation of "minerals" in a reservation. However, the majority view appears to be that the term describes all substances that may be severed from the soil for useful purposes, and that have an independent value when so severed. On the other hand, other courts have attempted to give effect to a definition of minerals from the standpoint of what the understanding of the parties was as to substances known to be classified as minerals. Under the latter view such a mineral as uranium would not be considered a part of the minerals granted if a mineral deed prepared forty years ago was under consideration. Such an interpretation could be avoided by adding the phrase, "whether presently known as minerals or hereafter found to be useful in the arts and sciences when severed from the land." On the other hand, it may be desirable to convey only specific minerals by name so as to clearly define the burden the surface owner will bear. Thus you create a mineral fee only in certain minerals. Also note that I said "minerals in and under Blackacre." The prepositions used to relate minerals to the tract should be carefully considered. Addition of the words "or that may be produced and saved" has caused courts to interpret this grant as the grant of a *royalty* interest.

If on the other hand the Landowner desires to retain the mineral interest and convey the surface, the severance is accomplished by a deed with a reservation of all oil, gas and other minerals. With regard to reservations, it is well to note that a whole body of mystic common law surrounds the distinction between an "exception" and a "reservation." Rather than become involved in an explanation of the distinction, I think the draftsman can proceed upon the judicial principle that the intention of the parties governs, and courts have been liberal in not recognizing any distinction between a reservation and an exception when it appears that it was intended to vest the grantor with the mineral estate. However, it is common practice in deeds to use the phraseology "excepting and reserving unto the grantor and his heirs and assigns forever all oil, gas, and other minerals."

After the foregoing transaction, we may say that Landowner is now the owner of the severed mineral interest, and he may execute further conveyances of his interest or lease it for development. First, he is free to transfer fractional parts of his estate by deed. If he transfers  $\frac{1}{2}$  of all oil, gas and other minerals in and under Blackacre to John Doe, Landowner and Doe are co-tenants in the estate. This means Doe has the same executive and non-executive rights with regard to the minerals as does Landowner. Since multiple conveyances of mineral interests may create many co-owners with the power to lease, such transactions frequently will reserve the power to lease Blackacre in one person so as to

expedite leasing. Second: Instead of conveying an interest in the mineral estate, Landowner can transfer one of the incidents of his estate. The most common fragment of ownership transferred is a part of Landowner's right to receive royalty.

It is at this point difficulties seem to arise. "Royalty" has two commonly accepted meanings (1) the landowner's share of production; (2) or more broadly, a share of production. The latter term, a share of production, is more useful generally in that any person entitled to a portion of oil and gas produced may divide this right by transfer by "royalty assignments."

If Landowner is perfectly certain that he wishes to part with a part of his right to royalty he may do so in terms of a stated fraction of all production from the premises ( $1/32$  royalty of all oil and gas produced from Blackacre), or a stated fraction of all royalties payable under future leases, assuming no lease in existence ( $1/4$  of all royalty paid on oil and gas produced from Blackacre—assuming a lease with a  $1/8$  royalty reserved, the assignee would receive  $1/32$ ). Time does not permit reference to the innumerable cases litigated to determine whether the stated fraction was to apply to *total* production or to the *royalty* reserved in a subsequent lease. But bear in mind that when the preposition *of* appears in an assignment it means "times." A person cannot be too careful in expressing the intention of the parties in this regard. If it is a royalty interest that is being transferred, the assignee of such interest does not receive any power to develop or lease the land for development; he does not receive any right to bonus, delay rental or any other royalty. I have heard it suggested that a draftsman in addition to being careful to designate this interest as "royalty" to be paid from oil and gas *produced* from Blackacre could well go on to affirmatively state that the grantor retains sole right to develop minerals, to execute leases and receive all benefits of the lease in the form of bonus and rentals. Such an approach would clearly negate any possible argument that the assignee was intended to receive other rights incident to the mineral estate.

The royalty I have been speaking of, which is created by the mineral interest owner, is called a perpetual non-participating royalty when no limitation is placed upon its duration. It may be limited as to time, as for the duration of a specific oil and gas lease upon the premises. It should be remembered that the holder of a royalty interest receives a stated fraction of oil cost free, whereas if a fraction of the mineral interest is transferred, the grantee is a co-tenant in the mineral estate and entitled only to his proportion of production less the costs of production. Normally the latter will have to join in a lease to get development and take his proportionate share of the usual  $1/8$  royalty.

Inasmuch as the royalty owner does not receive any power to develop or lease, he may well desire to have certain covenants included in the

instrument of assignment relative to how the owner of the mineral interest will exercise his powers.

Let us now look at the situation in which the owner of a mineral estate has executed a lease for oil and gas development. After the lease, the lessor has the following incidents of ownership: (1) Right to royalty, usually  $\frac{1}{8}$ , as provided in the lease; (2) Right to delay rentals and bonus as contracted for in the lease; (3) A reversion in the full incidents of the mineral estate. A conveyance of a part of the mineral interest will now also entitle the grantee to a proportionate share of rentals and royalty paid pursuant to the existing lease, unless the instrument expresses a contrary intention. Oftentimes draftsmen spell out the division of the royalty and rental in the instrument of conveyance. Care should be taken when doing this to watch the fractions utilized. If A conveys  $\frac{1}{2}$  the mineral estate, and wants to make clear  $\frac{1}{2}$  of royalties payable under the lease are to be paid to the grantee, it may be stated in this fashion. There have been instances in which  $\frac{1}{2}$  the mineral estate was granted and  $\frac{1}{16}$  of the royalty. While  $\frac{1}{16}$  may be  $\frac{1}{2}$  of  $\frac{1}{8}$ , the court may decide that the grantee was to receive  $\frac{1}{16}$  of  $\frac{1}{8}$ , or  $\frac{1}{128}$ .

In this situation the mineral conveyance has at times recited that the conveyance is "subject to an existing lease." This has led to considerably variety of interpretation and confusion, when nothing else is used to indicate what was intended by the phrase. Does it mean that the grantee gets only the reversion? Or does it mean he merely ratifies the terms of the lease? Suffice it to say at this time, that the draftsman can create greater certainty by setting forth the rights intended that the grantee acquire in the existing lease.

After the execution of the lease, it is clear that the lessee has acquired a certain number of the original incidents of the mineral estate: (1) Right to explore and develop; (2) Right to  $\frac{7}{8}$  of the oil and gas; (3) Other contractual rights set forth in the lease. Just as the mineral estate owner may transfer different incidents of his estate, so may the lessee transfer incidents of his leasehold. The most common incident severed from the working interest (that is the lessee's interest in  $\frac{7}{8}$  of production which bears the expense of production) is a fraction of the  $\frac{7}{8}$  production. The severance may be accomplished by assignment or reservation, and is normally referred to as an over-riding royalty. An overriding royalty may be defined as an interest in oil and gas produced at the surface, free of the expense of production, and in addition to the usual landowner's royalty reserved to the lessor in an oil and gas lease. It is quite common in farm-out agreements and in other assignments of leases that the assignor will reserve an overriding royalty. Such an interest may frequently be assigned as device for obtaining funds to finance drilling operations. While the landowner's royalty is typically  $\frac{1}{8}$ , there is no uniformity in the size of the overriding royalty. It is usually stated in terms of a fraction,

and it is at this point that the draftsman must exercise care. Inasmuch as the person creating the interest is entitled to only  $\frac{7}{8}$  of the production, it must be ascertained whether the parties intend the stated fraction, such as  $\frac{1}{32}$ , to apply to all of the production from Blackacre or to only  $\frac{7}{8}$  of the production. The assignment or reservation should be clearly drafted to indicate the parties intent, whether it be "a  $\frac{1}{32}$  royalty of all oil and gas produced from Blackacre," or " $\frac{1}{32}$  royalty of  $\frac{7}{8}$  of the oil and gas produced from Blackacre."

Perhaps the outstanding characteristic of overriding royalty is that its duration is limited by the duration of the lease under which it is created. Thus when the lessee of Blackacre assigns the lease to B, reserving a  $\frac{1}{32}$  overriding royalty, the continued existence of this interest depends on the acts of B in keeping the lease alive by paying delay rentals, producing oil before the expiration of the primary term, etc. Because of this characteristic of overriding royalty, it is common in assignment agreements to provide for notice by the assignee to the assignor of intention to allow the lease to lapse and in such event to require the reassignment of the lease. It is also common to find other provisions that extend the overriding royalty to any extensions or renewals of the lease.

I would now like to discuss what I have called "double fraction" problems in my outline. The double fraction problem arises whenever the grantor of an interest owns less than the entire fee simple and is going to grant or reserve a fractional part. In such a situation the draftsman must always bear in mind that there should be a clear statement of the basis to which the fraction conveyed applies. As just pointed out with regard to overriding royalty, the draftsman must be careful to clearly state whether the override applies to the assignor's share of production or to the total production.

However, the double fraction difficulty arises in many other types of situations. Suppose A owned an undivided  $\frac{1}{2}$  interest in Blackacre. A conveyed "All of A's right, title and interest in Blackacre." By a later provision in the same instrument A reserved to himself " $\frac{1}{32}$  part of all oil on and under the said land and premises herein described and conveyed." The question here is "Did A reserve  $\frac{1}{32}$  of all oil in and under Blackacre?" To answer this question we must first ascertain the meaning of the phrase "all oil on and under the said land and premises herein described and conveyed." What was conveyed? The "land" or just "A's interest in Blackacre" which was  $\frac{1}{2}$ . This makes a difference since the  $\frac{1}{32}$  applies to all oil under the land, or the  $\frac{1}{32}$  applies to A's  $\frac{1}{2}$  interest which would result in a  $\frac{1}{64}$  interest. In the Texas case of *Hooks v. Neill*, (21 S.W.2d 532) it was held that the "land" conveyed was the "interest" conveyed and not the physical land. In other words, although the draftsman referred to the "land" conveyed the court gave land a dual meaning—it can be a physical object or it can be the interest conveyed.

So the point is that whenever the grantor owns less than the entire fee, the draftsman must use care in reserving a fractional interest to clearly indicate whether the fraction applies to all oil underlying a certain described tract, or whether it applies to the interest conveyed.

That is one type of fraction problem. Another was recently illustrated in the Wyoming case of *Body v. McDonald* (1959, 334 P.2d 513, 10 O. & G. R. 103). To illustrate, let us say A conveyed Blackacre to B excepting and reserving  $\frac{1}{4}$  interest to all oil, petroleum, and other petroleum products. Shortly thereafter, B conveyed to C with an identical reservation. C knew of the prior reservation at the time of his obtaining a deed. Some forty odd years later C brought suit to quiet title to three-fourths of the mineral estate and was successful. Now you will recall that there had been two separate reservations of a  $\frac{1}{4}$  interest in grantors in the chain of title. However, all deeds had been warranty deeds, and the court held that since B warranted Blackacre to C with an exception and reservation of only  $\frac{1}{4}$  of the oil interest, the deed effectively warranted the surface and  $\frac{3}{4}$  of all the oil rights. By such a warranty B is estopped to deny that C owns that quantum of the estate. Although C knew of both reservations, estoppel by deed is not to be considered as resting upon the same principles as an equitable estoppel, as a warranty is put in a deed for the express purpose of estopping the grantor to the extent of the words used. This decision clearly stresses the importance of the draftsman, who prepares a warranty deed, knowing the status of the title so as to specifically except prior reservations of minerals, or include a blanket exception of all prior reservations of record.

Double fraction problem can arise in many forms in oil and gas conveyancing. A recent 10th Circuit case (*Brenimer v. Cockburn*, C.A. 10th Cir. Wyo., 254 F.2d 821) presented a situation in which A had acquired a fifty per cent working interest as part of an operating agreement in which he assumed the development obligations. Thereafter he made assignments of "1% of all the oil and gas hereafter developed or discovered . . . in the lands . . . described in the oil and gas leases . . . pursuant to the Operating Agreement." The issue that went to the 10th circuit was whether the 1% referred to all of the production from the leases, or just to the 50% interest owned by A (assuming normal leases and no overrides, this would be 1% of 50% of 87 $\frac{1}{2}$ %). The court held that the instrument assigned 1% of all oil and gas produced from the land. So again we have a situation in disagreement which arose because the parties could find a basis for arguing as to whether the 1% referred to the assignor's "interest" or to the total physical production from described land.

The last and perhaps most complex type of fraction problem I want to mention is presented in the case of *Benge v. Scharbauer* (259 S.W.2d 166, 2 O. & G.R. 1350, Tex. Sup. Ct. 1953). A owned the surface and

$\frac{3}{4}$  of the minerals. A conveyed to B and granted Blackacre. The grant was followed by a reservation to A of  $\frac{3}{8}$  of the mineral interest, less the power to lease, which power was conveyed to B. Thereafter A attempted to reserve, expressly,  $\frac{3}{8}$  of bonuses, delay rentals and royalties. How do you define mineral ownership between A and B?

Note the problem again. At the time of A's conveyance there is outstanding  $\frac{2}{8}$  of the mineral interest, but A attempted to reserve  $\frac{3}{8}$ . This would give the grantee B, only a  $\frac{3}{8}$  interest. But by applying estoppel by deed, we reach the result that B must get  $\frac{5}{8}$  of the mineral interest, so that A effectively reserved only a  $\frac{1}{8}$  interest. This is in accord with accepted doctrine. But how about the right to bonus, rental, and royalty? Normally these rights are commensurate with the extent of mineral ownership. In the fact situation, however, the Court concluded that the parties had indicated a specific agreement that A was to receive  $\frac{3}{8}$  of these incidents that arise pursuant to the contractual terms of a lease. Hence, the decision in effect recognized a conveyance with a split personality. A owns  $\frac{1}{8}$  of the mineral interest, but is entitled to  $\frac{3}{8}$  of the royalty, bonus and delay rentals.

Perhaps I have attempted to oversimplify problems in the drafting of mineral or royalty conveyances. But I do feel that careful consideration and analysis of the nature of the interests will inevitably lead to careful draftsmanship that will so clearly express the parties' intent, that litigation will not follow. Of course there can be no guarantee. This is illustrated by the recent case of *Corlett v. Cox* (333 P.2d 619). There a warranty deed contained the following clause: "hereby reserves  $6\frac{1}{4}\%$  of all gas, oil and minerals that may be produced on any or all the above mentioned land, or in other words reserves  $\frac{1}{2}$  of the usual  $\frac{1}{8}$  royalty." I think that I can say that most oil and gas people would construe this as the reservation of a royalty interest. However, there was no oil and gas lease in existence at the time, and the court concluded after a review of the theoretical nature of ownership of oil and gas that the parties actually intended the reservation of a mineral interest. The point of this illustration is merely to remind you that draftsmen must constantly be aware of the jurisdiction's theory of ownership of oil and gas, and its incidents. If there are no past guiding decisions, extreme care must be exercised in spelling out the intended effect of the conveyance upon all of the parts into which mineral ownership can be divided.