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Oil and Gas

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OIL AND GAS

EFFECT OF CONVEYANCE OF MINERALS IN PART OF
LEASED TRACT (TEXAS)

In 1949 the Texas Supreme Court was again faced with the problem indicated by the caption. In *Garza v. DeMontalvo*,¹ A, B and C² owned a tract of land. They also owned another tract, unless a deed by their ancestor validly vested title to the tract in B and C. A, B and C executed an oil and gas lease covering both tracts. Later, while this lease was in effect, A, B and C voluntarily partitioned, a specific tract being set aside to each. No mention was made in the partition agreement of the outstanding lease. Thereafter production was secured under the lease upon C's tract. The court held that all royalties accruing by reason of such production were the property of C. The court said that this was so even assuming that at the time of the lease A, B and C owned one of the tracts and B and C the other, and assuming that as a result of the lease the rights to royalties, prior to the partition, were pooled.

If a mineral deed is executed subsequent to a lease and covers only a part of the property covered by the lease, but recites that the grantee shall be entitled to a designated part of royalties payable under the lease, the grantee is entitled to such share even though production is not upon the portion described in his deed.³ On the other hand, if the clause "insofar as said lease covers the above described land" is added, or if the lease is not referred to, the grantee may be restricted to his own tract, but as to that tract he may be entitled to the entire fractional share set forth in his deed. Where the outstanding lease does not contain a provision pooling royalties, there is a conflict of authority as to whether the royalties will be pooled when the tract is later divided and is held

¹ 147 Tex. 525. 217 S. W. 2d. 988 (1949).

² There were actually numerous heirs. The facts have been simplified for convenience.

³ *Hoffman v. Magnolia*, 273 S. W. 828 (Tex. Comm. App. 1925).

in severalty by two or more persons.⁴ Where it does contain such a provision, it has been held that the fractional interest will be pooled,⁵ unless, of course, the parties expressly stipulate otherwise.⁶

The principal case is the first one in Texas construing a subsequent change in ownership under a pooled lease. It should be noted, however, that pooling impliedly resulted from the owners of several tracts joining in one lease,⁷ whereas in the cases holding that a subsequent grant was subject to pooling, the clause, known as an "entirety clause" specifically provided for this result.

The principal case holds that the transactions in question evidenced an intent to limit the interests of each party to his own tract. It is submitted that the holding should be limited to facts clearly evidencing such an intention. In the absence of such evidence, it would seem that a more just result would be reached by construing the instrument as one providing for pooling under the existing lease.⁸

EFFECT ON MINERAL RESERVATION OF PURCHASE AT TRUSTEE'S SALE BY ASSUMING GRANTEE (TEXAS)

In *Cecil v. Dollar*,⁹ Cecil sold an encumbered tract to Blount, reserving a one-half mineral interest. Blount assumed the debt.

⁴ Cases on both sides are cited in *Carlock v. Krug*, 99 P. 2d. 858 (Kan. 1949).

⁵ *Eason v. Rosamond*, 173 Okla. 10, 46 P. 2d. 471 (1935).

⁶ *Wilson v. Holn*, 164 Kan. 229, 188 P. 2d. 899 (1948).

⁷ *French v. George*, 159 S. W. 2d. 566 (Tex. Civ. App. 1942), *writ of error refused*; *Parker v. Parker*, 144 S. W. 2d. 303 (Tex. Civ. App. 1940), *writ of error refused*.

⁸ In the more recent case of *Grelling v. Allen*, 218 S. W. 2d. 896, 898 (Tex. Civ. App. 1949), *writ of error refused, N.R.E.*, the court said:

"We might assume a situation in which Allen, after leasing his 88 acres of land comprising the five adjoining tracts, divided the entire tract into eighty-eight parcels of one acre each, and thereafter sold the eighty-eight parcels to various persons, subject to the lease covering the eighty-eight acre tract. It would hardly be logical, in the event that a producing well was drilled on one of such one acre tracts, that the owner of such tract would be entitled to all of the royalty produced from that well. We think that under such circumstances all of the owners of the one acre tracts would participate in the royalty produced from a well drilled on any portion of the subdivided large tract."

⁹ 147 Tex. 547, 218 S. W. 2d. 415 (1949).

Blount later conveyed to Dollar, who also assumed, this deed excepting the one-half mineral interest. Dollar and the mortgagee thereafter entered into an extension agreement. Still later, upon default by Dollar, the property was sold at a trustee's sale at which Dollar was the purchaser. The present suit was in trespass to try title by Cecil's widow against Dollar. The appeal involved these questions: (1) the effect of the extension upon the mineral interest of Cecil; (2) the extent, if any, of the title acquired by Dollar at the trustee's sale; (3) as ancillary to the second question, the limitation period applicable to Cecil's right to sue. The court held, in effect, that the extension bound Cecil's interest, that the purchase by Dollar inured to Cecil's benefit, and that the interest thus acquired by Cecil was a present title. Thus, as Cecil did not need a suit to vest title, the limitation periods applicable to bringing suit were not a bar.

As to the first point, the court cites and is supported by the earlier case of *Texas Land and Mortgage Co. Ltd. v. Aaron Cohen*.¹⁰ While in both of these cases the party bound by the extension reserved an interest, there is a possible inconsistency between the result reached and the principle sometimes applied that after a conveyance to one who assumes, the mortgagor's status is that of a surety, it following that an extension agreement between the assuming grantee and the mortgagee releases the mortgagor.¹¹

As to the other point, that the purchase by an assuming grantee inures to the benefit of the grantor's reserved interest, the case seems to reach a just and correct result. The principle applied finds its counterpart in the doctrine of after-acquired title¹² and the rule that payment of a debt by one primarily liable as to all other parties operates as a discharge of the debt.

¹⁰ 138 Tex. 464, 159 S. W. 2d. 859 (1942).

¹¹ *Wilson v. J. W. Crowder Drug Co.*, 222 S. W. 223 (Tex. Comm. App. 1920); Hildebrand, *Contracts for the Benefit of Third Parties in Texas*, 12 Tex. L. Rev. 125, 152 (1931).

¹² *W. O. Cherry v. Farmers Royalty Holding Co.*, 138 Tex. 576, 160 S. W. 2d. 908 (1942).

VALIDITY OF REGULATION PROHIBITING FLARING (TEXAS)

The present policy of the Railroad Commission is to prohibit as far as practicable the flaring or loss of gas from wells producing both oil and gas. In *Railroad Commission of Texas v. Sterling*¹³ the Texas Supreme Court reviewed such an order and held, two justices dissenting, that under the facts established at the trial, the order in question was reasonable and valid. The court also held that the matter was properly presented by a direct appeal to the supreme court from the Travis County District Court. The opinion reaffirms the holding of the *Hawkins* case¹⁴ that an order is valid if supported by substantial evidence in the trial court; that whether there was such substantial evidence is a question of law; and that in determining the question the court will examine the whole record.

EFFECT OF RESERVATION OF ONE-SIXTEENTH MINERAL INTEREST (OKLAHOMA)

In the case of *Hinkle v. Gaunt*¹⁵ the court was called upon to construe the following reservation: "Excepting a one-sixteenth (1/16) interest in the oil and gas deposits that may be developed on said land, and also an undivided one-half (1/2) interest in the bonus or rental of oil and gas lease now existing against said land, and the crop rental for the year 1919." The question was whether in the event of production under an oil and gas lease covering the one-sixteenth, the owner thereof was entitled to one-sixteenth of the gross or to one-sixteenth of the royalty reserved in the lease. The court adopted the latter construction, holding that the owner of the reserved interest was entitled to one-sixteenth of royalties reserved in valid leases covering this interest.

Parties dealing with mineral and royalty interests frequently think of the mineral owner as owning one-eighth. This is because

¹³ 147 Tex. 547, 218 S. W. 2d. 415 (1949).

¹⁴ *Hawkins v. Texas Co.*, 146 Tex. 511, 209 S. W. 2d. 338 (1948).

¹⁵ ———Okla.———, 206 P. 2d. 1001 (1949).

of the custom in the industry of reserving an eighth royalty to the mineral owner in an oil and gas lease covering his interest. The cases now seem fairly uniform in holding that a conveyance of a mineral interest without reference to existing or future leases conveys the designated fraction of royalties reserved in such leases.¹⁶

A preliminary problem is whether the deed is a mineral deed or a royalty deed. Thus, the court in the principal case cited the earlier Oklahoma case of *Swearingen v. Oldham*,¹⁷ which involved this reservation: "The grantors reserve to themselves one-sixteenth (1/16) of all oil, gas, or other minerals in or under this land but convey unto grantee full rights to lease this land for any purpose and to collect and retain all rentals and bonuses." The court apparently construed this as a royalty deed — that is, as one limited to participation in production. This seems correct. The mere fact that an interest is *called* a mineral interest should not control the substance of the matter: *i.e.*, a royalty interest is one limited to participation in production; therefore, an interest so limited is a royalty interest, whatever it may be called.

Granting that a given interest is a royalty interest, should the same rule be applied to a mineral interest? That is, if a 1/16 mineral interest grants a right to 1/16 of royalties, should a 1/16 royalty interest grant the same right? The argument in favor of making a distinction is that the parties know, or should know, that a mineral interest must contribute its proportionate share to the interest of the lessee, whereas the owner of the royalty interest is not even a necessary party to the lease. Apparently the Oklahoma court would reject this argument. On the other hand, it seems clear that in Texas a 1/16 royalty interest, or a 1/16 mineral interest payable as royalty, entitles the owner thereof to that fraction of gross production.¹⁸ An interesting question would be pre-

¹⁶ See, for example, *Harris v. Currie*, 142 Tex. 93, 176 S. W. 2d. 302 (1943).

¹⁷ 195 Okla. 532, 159 P. 2d. 247 (1945).

¹⁸ *Watkins v. Slaughter*, 144 Tex. 179, 189 S. W. 2d. 699 (1945); *Brown v. Smith*, 141 Tex. 425, 174 S. W. 2d. 43 (1943); see *Bellport v. Harrison*, 123 Kan. 310, 255 Pac. 52 (1927).

sented by the grant or reservation of a fractional royalty interest the denominator of which is a number less than 8—as, for example, a one-half royalty interest.

EFFECT OF RESERVATION OF PARTIAL INTEREST UNDER A LEASE COVERING ONLY A PARTIAL INTEREST (ARKANSAS)

In *Pollock v. McAlester Fuel Co.*¹⁹ the Arkansas Supreme Court had before it this problem: An oil and gas lease by its express terms covered an undivided $\frac{1}{2}$ interest in a 20-acre tract. Near the end of the printed form the parties inserted a typewritten provision reading, "The lessors herein expressly reserve unto themselves, their heirs or assigns, an undivided $\frac{1}{16}$ of $\frac{7}{8}$ of the total oil and gas and other minerals produced, saved and marketed under the terms of this lease, to be delivered to the lessors free of cost in tanks or pipelines to which lessee, their heirs, successors or assigns may connect wells, said interest being commonly known as 'overriding royalty interest'." The question was whether this provision reserved to lessors a $\frac{1}{16}$ of gross production or a $\frac{1}{16}$ of the lessor's $\frac{1}{2}$, being $\frac{1}{32}$ of the gross. The court held that it reserved $\frac{1}{16}$ of $\frac{1}{2}$. The basis for this holding was that part of the last quoted clause which limited payments to "minerals produced, saved and marketed under the terms of this lease," which lease expressly covered only a one-half mineral interest. The court left open the question whether the partial ownership clause²⁰ applied to this payment.

The principal case illustrates the importance of two fertile fields for error or ambiguity in preparing mineral deeds and leases. The first is usually presented by a mineral or royalty deed. Many forms include a provision that the grant is subject to a designated lease, but covers and includes a specified fractional interest in payments made under the lease. If the lease in turn covers only

¹⁹ —Ark.—, 223 S. W. 2d. 813 (1949).

²⁰ This is the provision found in all, or practically all, leases to the effect that if the lessor owns less than the entire fee simple title, rentals and royalties shall be proportionately reduced.