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Pitfalls in Developing Lands Burdened by Non-Participating Royalty: Calculating the Royalty Share and Coexisting with the Duty Owed to the Non-Participating Royalty Owner by the Executive Interest [reprint, first published 1995]

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ONE J

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PITFALLS IN DEVELOPING LANDS BURDENED BY
NON-PARTICIPATING ROYALTY: CALCULATING
THE ROYALTY SHARE AND COEXISTING WITH
THE DUTY OWED TO THE NON-PARTICIPATING
ROYALTY OWNER BY THE EXECUTIVE INTEREST*
[reprint, first published 1995]

PHILLIP E. NORVELL**

I. Introduction

Non-participating royalty may be severed¹ from the mineral estate,² and when severed, only entitles the owner to its prescribed share of production,

* This article was originally published in the *Arkansas Law Review*. See Phillip E. Norvell, *Pitfalls in Developing Lands Burdened by Non-Participating Royalty: Calculating the Royalty Share and Coexisting with the Duty Owed to the Non-Participating Royalty Owner by the Executive Interest*, 48 ARK. L. REV. 933 (1995). The Journal would like to thank Professor Norvell and the editorial staff of the *Arkansas Law Review* for their permission to republish the article. For more information about the *Arkansas Law Review*, visit <http://media.law.uark.edu/arklawreview/>.

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1. A non-participating royalty interest may be created by grant or by reservation. To facilitate this discussion, the terms will be used interchangeably.

2. A non-participating royalty interest may be for a fee, term or defeasible term. For a discussion of term and defeasible term royalty interests, see Phillip E. Norvell, *Defeasible Term Mineral and Royalty Interests*, 24TH ANNUAL ARKANSAS NATURAL RESOURCES LAW INSTITUTE (1985). Also, for an examination of the nonparticipating royalty deed form that has been traditionally utilized in Arkansas, see Oliver M. Clegg, *The Arkansas Royalty Deed: Questions and Answers*, 21ST ANNUAL ARKANSAS NATURAL RESOURCES LAW INSTITUTE (1982).

cost-free. The nonparticipating royalty owner does not participate in the executive right, the right to execute oil and gas leases, or in bonus or delay rental payments.³ Oil and gas prospects burdened by non-participating royalty interests present two initial issues that the operator contemplating leasing and subsequent development should consider. As a preliminary step, non-participating royalty conveyances must be interpreted to determine the share of gross production that is conveyed. Central to determining the share of gross production conveyed is the issue of whether the interest created is a *fractional share* royalty or a *fraction of* royalty. This article will discuss the difference between a non-participating *fractional share* and a *fraction of* royalty and review the peculiar problems that beset the interpretation of royalty conveyances when determining which of these distinct interests has been created.

Additionally, this article also will discuss the standard of care that the executive right holder owes to the non-participating royalty owner in negotiating the lease royalty. Likewise, the basis for imposing liability on an oil and gas lessee who secures an oil and gas lease from the executive right holder who violates the duty of care owed to the nonparticipating royalty owner will also be explored. The standard of care that the executive right holder owes to the non-participating royalty owner in negotiating the oil and gas lease may be an additional basis of liability for the oil and gas lessee. Compensatory and exemplary damages, or lease cancellation, may be incurred by the oil and gas lessee who negotiates the lease from a culpable executive right holder.

II. The Difference Between The Fractional Share And The Fraction Of Non-participating Royalty

The difference between a non-participating *fractional share* royalty and a *fraction of* royalty is simple, yet illusive. First, a *fractional share* royalty entitles the owner to only that specified fractional quantum of gross production stated in the deed. In essence, the effect of a *fractional share* conveyance of royalty is to transfer “a fraction or percentage of gross production that stands as a free royalty.”⁴ The share of gross production that the *fractional share* is entitled to is fixed by the fractional size of the interest conveyed by the deed, regardless of the amount of royalty

3. *Wynn v. Sklar*, 493 S.W.2d 439 (Ark. 1970); *Hanson v. Ware*, 274 S.W.2d 359 (Ark. 1955); *Arkansas Valley Royalty Co. v. Arkansas-Oklahoma Gas Co.*, 258 S.W.2d 51 (Ark. 1953).

4. 2 HOWARD R. WILLIAMS & CHARLES J. MEYERS, *OIL & GAS LAW* § 327.1 (1994).

contained in a subsequent oil and gas lease.⁵ For example, the language conveying “an undivided $\frac{1}{16}$ th of all of the oil, gas, and other minerals produced and saved,” entitles the royalty owner to a $\frac{1}{16}$ th share of gross production regardless of the fact that the landowner’s royalty reserved in the oil and gas lease is a $\frac{1}{8}$ th, $\frac{3}{16}$ th or $\frac{1}{4}$ th royalty.⁶ A fractional share royalty interest does not participate in any overriding royalty reserved in an oil and gas lease that may be in addition to the landowner’s royalty.⁷

Conversely, a non-participating *fraction of* royalty conveys that fractional share of royalty that is contained in the oil and gas lease.⁸ For example, a $\frac{1}{2}$ of non-participating royalty, with an oil and gas lease providing for a $\frac{1}{8}$ th royalty, is entitled to a $\frac{1}{16}$ th part of gross production. Likewise, if the oil and gas lease provides for a $\frac{3}{16}$ th of royalty, a $\frac{1}{2}$ of non-participating royalty is entitled to $\frac{3}{32}$ nds of gross production. In effect, the *fraction of* the non-participating royalty’s share of production is not “fixed” but “floats” in accordance with the size of the landowner’s royalty contained in the lease.⁹ In addition to the landowner’s royalty, *the fraction of* non-participating royalty also shares proportionally in any overriding royalty interest reserved in the oil and gas lease if the interest *is* a royalty.¹⁰ Because the holder of the executive right negotiates the landowner’s royalty share in the oil and gas lease and thus determines the share of royalty that the *fraction of* non-participating royalty owner receives, the executive owner owes a duty of care to the non-participating royalty owner in establishing the landowner’s royalty.

The question of whether a non-participating royalty conveyance creates a fractional share or a fraction of royalty presents an issue of construction teeming with complications. The fact that the standard landowner’s royalty in the oil and gas lease for approximately 50 years was a $\frac{1}{8}$ th share looms large in the confusion. This customary $\frac{1}{8}$ th share furnished the background in which non-participating royalty interests were created during that era. Therefore, a person wanting to reserve a share of the landowner’s $\frac{1}{8}$ th royalty, as for example $\frac{1}{2}$ of that interest, could express it in either one of two ways: the reservation could be expressed as a fraction of royalty, for example $\frac{1}{2}$ of the royalty, entitling the person to $\frac{1}{16}$ th share of gross

5. *Id.*

6. *Id.*

7. Barret v. Kuhn, 572 S.W.2d 135 (Ark. 1978); Helms v. Guthrie, 573 S.W.2d 855 (Tex. Ct. App. 1978).

8. 2 WILLIAMS & MEYERS, *supra* note 4, § 327.2.

9. 2 WILLIAMS & MEYERS, *supra* note 4, § 327.2.

10. *See infra* note 94.

production, or the reservation could be expressed as a straight fractional share, for example a $\frac{1}{16}$ th share of gross production, also entitling the person to $\frac{1}{16}$ th share of gross production. Thus, for many years, as a practical matter, a fractional share and a fraction of royalty were synonymous.¹¹ In fact, as will be seen, many non-participating royalty interests were created by instruments that utilized both a fractional share and a fraction of royalty. One expression may be found in one clause of the deed, such as the granting clause, while the alternative expression appears in either a “subject to” or a “future leasing” clause.

Over the last twenty years the landowner’s royalty in the oil and gas lease has increased to a greater fractional share, such as a $\frac{3}{16}$ th or $\frac{1}{4}$ th. Consequently, a *fractional share* or a *fraction of* royalty are no longer synonymous but instead yield different shares of gross production. The *fraction of* designation, created during the era in which the $\frac{1}{8}$ th landowner’s royalty was all but universal and was the background for the transaction, yields a greater share of production than its historic counterpart, the *fractional share* designation.

To further complicate matters, some laypersons had difficulty with fractions in general, particularly during the old days when less of the populace was educated. Moreover, the distinction between these two different royalty designations is often slight, and some laypersons, as well as lawyers, simply fail to comprehend the difference.

III. Delineating The Difference Between A Fractional Share And A Fraction Of Royalty

The distinction between *fractional share* royalty interests and *fraction of* royalty interests may best be illustrated by examples from case law. A common example of a fractional share non-participating royalty is the grant of a fraction of gross production or its equivalent. For example, “an undivided $\frac{1}{24}$ th of all the oil, gas, and other minerals produced, saved and made available for market” was held to convey a *fractional share* royalty interest entitling the grantee to a $\frac{1}{24}$ th share of gross production.¹²

11. Ernest E. Smith, *Conveyancing Problems*, State Bar of Texas Professional Development Program: Advanced Oil, Gas and Mineral Law Course, at G-1 (1981) [hereinafter Smith 1],

12. *Miller v. Speed*, 248 S.W.2d 250 (Tex. Ct. App. 1952). *See also* *Hanson v. Ware*, 274 S.W.2d 359, 360 (Ark. 1955), wherein the granting clause to a 1919 royalty deed conveyed a “one-sixteenth part of all oil and gas produced and saved.”

The *fractional share* conveyance may also utilize a fraction in reference to “royalty” as a synonym for gross production. Thus, a reservation of “a $\frac{1}{16}$ th royalty from any oil and gas produced” entitles the grantor to a $\frac{1}{16}$ th share of gross production.¹³ Similarly, a grant of “a fee royalty of $\frac{1}{32}$ of the oil and gas” was held to create a *fractional share* $\frac{1}{32}$ nd interest in gross production.¹⁴

Conversely, the common example of a *fraction of* nonparticipating royalty is the grant of “ $\frac{1}{2}$ of royalty.”¹⁵ The share of gross production is the specified fraction of the amount of the oil and gas lease royalty. As has long been observed, the “fraction of royalty” designation is equivalent to a mathematical formula that determines the quantum of gross production involved.¹⁶ The term “of” that follows the fraction ($\frac{1}{2}$) and precedes the term “royalty” means “times” and requires the fraction to be multiplied by the lease royalty to determine the quantum of gross production. Thus, when the lease royalty is $\frac{1}{8}$ th, $\frac{1}{2}$ of royalty equals $\frac{1}{16}$ th of gross production. Yet that same fraction of royalty equals $\frac{3}{32}$ nds of gross production when the lease royalty is $\frac{3}{16}$ ths.

A *fraction of* royalty has also been expressed by language that indicates the fraction is an interest *in the royalty*. For example, a grant of a “one-half ($\frac{1}{2}$) interest in all royalties” was held to convey “one-half ($\frac{1}{2}$) of the royalty” reserved in the mining lease.¹⁷ Also, a deed reserving “one-half ($\frac{1}{2}$) interest in and to the royalty rights” was held to reserve $\frac{1}{2}$ of the

13. *Karaker v. Unknown Heirs*, 434 P.2d 282 (Okla. 1966). In *Karaker*, the court was construing a reservation in a 1922 deed. The sole issue was whether the reservation reserved a $\frac{1}{16}$ th of gross production or only a $\frac{1}{16}$ th of a $\frac{1}{8}$ th royalty. The court found the reservation ambiguous. Moreover, the court admitted into evidence a 1924 oil and gas lease that provided that the lease royalty was to be divided one-half ($\frac{1}{2}$) equally between the grantor and grantee of the deed. The court held that the reservation was to a $\frac{1}{16}$ th of gross production as a non-participating royalty. In reaching this result, the court emphasized that the reservation stated *$\frac{1}{16}$ th royalty* of any oil and gas produced, as opposed to $\frac{1}{16}$ of any *royalty interest*, noting that a distinction exists between the term “royalty” and “royalty interest.”

14. *Caraway v. Owens*, 254 S.W.2d 425 (Tex. Ct. App. 1953).

15. See *Helms v. Guthrie*, 573 S.W.2d 855 (Tex. Ct. App. 1978), wherein dicta noted that a grant of “one-fourth ($\frac{1}{4}$ th) of the royalty” conveyed a “fraction of royalty” and the ultimate share of production accruing to the interest was “determinable upon the execution of some future lease.” *Id.* at 857. The grantee received $\frac{1}{4}$ th of the $\frac{1}{8}$ th lease royalty as well as $\frac{1}{4}$ th of $\frac{1}{16}$ th of the $\frac{7}{8}$ th overriding royalty reserved in a subsequent oil and gas lease.

16. It is accepted convention “that ‘of’ is the same as ‘times’ in a multiplication formula.” 6 W.D. Masterson, Jr., OIL & GAS REPORTER, at 1372 (1956) (discussing *Minchen v. Hirsch*, 295 S.W.2d 529 (Tex. Ct. App. 1956)).

17. *J.M. Huber Corp. v. Square Enter., Inc.*, 645 S.W.2d 410 (Tenn. Ct. App. 1982).

royalty to be paid under any existing or future lease.¹⁸ Similarly, a reservation of “an equal one-eighth ($\frac{1}{8}$ th) of any royalty of all oil . . . [or] gas . . . developed on or received from said land” reserved a $\frac{1}{8}$ th of royalty, which due to the royalty in the lease being $\frac{1}{8}$ th, reserved a $\frac{1}{8}$ th of $\frac{1}{8}$ th, or a $\frac{1}{64}$ th, share of gross production.¹⁹

IV. The Problem Areas

A. A Fraction of a $\frac{1}{8}$ th Royalty

Some non-participating royalty conveyances have utilized a *fraction of a* $\frac{1}{8}$ th royalty to fix the quantum of the royalty share. The effect is to create a *fractional share* royalty. For example, a grant of “ $\frac{1}{2}$ of the $\frac{1}{8}$ th royalty (same being $\frac{1}{16}$ th of total production)” conveys a $\frac{1}{16}$ th share of gross production despite the fact that the lease royalty may be in excess of a $\frac{1}{8}$ th share.²⁰ The plain meaning of the specific language utilized dictates the *fractional share* construction. After all, $\frac{1}{2}$ of $\frac{1}{8}$ th equals a $\frac{1}{16}$ th share. The specific language of the grant or reservation precludes a construction of anything other than a fractional share of gross production. Thus, the courts give a literal interpretation to the fraction of $\frac{1}{8}$ th non-participating royalty which results in a *fractional share* construction.

That result, however, has not gone unquestioned. Dean Ernest Smith has observed that the *general intent* of the parties to the conveyance of a *fraction of a* $\frac{1}{8}$ th royalty was to convey a fraction of whatever royalty share was subsequently provided for in the lease.²¹

In essence, under Smith’s theory, the $\frac{1}{8}$ th fraction appearing in the formula was not only synonymous with the oil and gas lease royalty share but signified the lease royalty share, whatever that share subsequently became. Thus, a $\frac{1}{4}$ th of $\frac{1}{8}$ th royalty would be construed as a $\frac{1}{4}$ th of royalty or a *fraction of* royalty, entitling the royalty owner to share in lease royalty in excess of $\frac{1}{8}$ th. The hypothesis for Smith’s *general intent* for a *fraction of* royalty construction is the historical ubiquity of the oil and gas lease royalty

18. Schlittler v. Smith, 101 S.W.2d 543 (Tex. Ct. App. 1937).

19. Nourse v. Kovacevich, 109 P.2d 999 (Cal. Ct. App. 1941).

20. Helms v. Guthrie, 573 S.W.2d 855 (Tex. Ct. App. 1978). In *Helms*, the grantee in the deed sued to recover a $\frac{1}{16}$ th share of a $\frac{1}{16}$ th of $\frac{7}{8}$ ths overriding royalty interest that had been reserved in the lease in addition to the $\frac{1}{8}$ th royalty share. In Texas, as noted in the case, overriding royalty is royalty. The court held that Helms was only entitled to a $\frac{1}{16}$ th of gross production. The court observed that Helms owned “a ‘fractional royalty’ of $\frac{1}{16}$ th of the total production, not a ‘fraction of royalty,’ determinable upon the execution of some future lease.” *Id.* at 857.

21. Smith I, *supra* note 11, at G-1.

as a $\frac{1}{8}$ th share and the probability that the parties never considered the possibility of a lease providing for a greater royalty share. Smith recognizes, however, that the specificity as to the quantum of royalty inherent in the fraction of $\frac{1}{8}$ th royalty conveyance, i.e., the specific intent, precludes any contradiction of such terms by a general intent based on historical facts or assumptions.²² Thus, despite his qualms, Smith recognizes that the *fractional share* construction will prevail as the fraction of $\frac{1}{8}$ th royalty formula.

Nevertheless, cases exist which deal with deeds or reservations of a fractional share of $\frac{1}{8}$ th royalty which bear the suspicion that Smith's general intent theory is not far off the mark. One such case is *Canter v. Lindsey*²³ from the Texas Civil Court of Appeals. In that case, Dora Roberts owned the fee mineral estate to 17,712 acres of land. In 1935, she conveyed to M. C. Lindsey as follows:

ONE FOURTH OF ONE EIGHTH ($\frac{1}{4}$ of $\frac{1}{8}$) of all the oil, gas, and other minerals produced from the following described land . . . the interest herein conveyed being an equal one fourth of one eighth ($\frac{1}{4}$ of $\frac{1}{8}$) part of all of the oil, gas, and other minerals when same has been produced from said land, and to such extent, such part of any and all future productions of such is hereby conveyed.²⁴

The deed also reserved to the grantor the right to all bonuses, delay rentals and executive rights.

Thereafter, in 1941, Roberts executed the following deed to J. E. Mabee:

That I, Dora Roberts, . . . do GRANT, SELL, and CONVEY unto the said J. E. Mabee, . . . , a three-fourths ($\frac{3}{4}$) interest, undivided, in and to all of the oil, gas and other minerals, on, in, and under the certain tracts, parcels and pieces of land . . .²⁵

The next clause of the deed conveyed to Mabee all the executive, bonus and delay rental rights, "as well as all other benefits accruing thereunder," to the remaining $\frac{1}{4}$ th interest.

22. Smith I, *supra* note 11, at G-2.

23. 575 S.W.2d 331 (Tex. Ct. App. 1978).

24. *Id.* at 333.

25. *Id.*

That clause continued as follows:

save and except the royalty payable under any such lease covering such $\frac{1}{4}$ th interest, all royalty accruing under any such lease on such $\frac{1}{4}$ th interest being payable to M. C. Lindsey, his heirs and assigns, who owns an undivided one-fourth ($\frac{1}{4}$) non-participating royalty interest in the oil, gas and other minerals in said land²⁶

The deed then recited that Lindsey did not own any executive, bonus, or rental rights, such rights having been retained by Roberts in Lindsey's deed, and repeated that such rights were conveyed to Mabee who would then solely own all executive, bonus, and delay rental rights. As to royalty, the instrument concluded by stating that Mabee would own:

the right to receive only three-fourths ($\frac{3}{4}$) of the royalty accruing under any such lease, or leases, the remaining one-fourth ($\frac{1}{4}$) interest in such royalty being owned by M. C. Lindsey, his heirs and assigns.²⁷

In 1973, an oil and gas lease covering part of the land was executed that provided for a $\frac{3}{16}$ ths royalty, and production was established on the lease. A declaratory judgment action was then instituted to determine the ownership of the $\frac{1}{16}$ th lease royalty share attributable to the $\frac{1}{4}$ th of royalty interest reserved in the Mabee deed that was in excess of the $\frac{1}{8}$ th royalty share. Predictably, all of the parties to the original conveyances were deceased, but the heirs and successors-in-interest of Lindsey, Mabee, and Roberts²⁸ sought to recover the $\frac{1}{16}$ th royalty share.²⁹

26. *Id.*

27. *Id.*

28. To facilitate the discussion, as in the appellate court opinion, the parties will be referred to as the principals, Lindsey, Roberts, and Mabee, as opposed to their successors-in-interest.

29. To facilitate an understanding of the case, the calculation of the lease royalty shares pursuant to the theories of the different claimants appears below.

Lindsey, the plaintiff, claimed a $\frac{1}{4}$ th of the $\frac{3}{16}$ th royalty, or $\frac{3}{64}$ th of gross production. He recognized the defendant, Mabee, as owning $\frac{3}{4}$ th of $\frac{3}{16}$ th or $\frac{9}{64}$ ths of gross production while Roberts, the intervenor, pursuant to Lindsey's theory, was entitled to no royalty.

Mabee, the defendant, claimed he was entitled to all royalty reserved under any lease in excess of $\frac{1}{4}$ th of $\frac{1}{8}$ th ($\frac{1}{32}$ nd), with the ownership of the $\frac{3}{16}$ th lease royalty being as follows: (1) Lindsey owning $\frac{1}{4}$ th of $\frac{1}{8}$ th to equal fend share of gross production and (2) Mabee owning a full $\frac{3}{16}$ th minus Lindsey's fend share, entitling Mabee to $\frac{10}{64}$ ths. Roberts, again, was entitled to no royalty.

Lindsey maintained that he acquired the excess $\frac{1}{16}$ th royalty share by virtue of the 1935 deed. Lindsey argued, in part, that the deed conveyed a $\frac{1}{4}$ th of $\frac{3}{16}$ th, equal to a $\frac{3}{64}$ th, royalty share in production from the 1973 lease. Lindsey prevailed at the trial court, but the Court of Appeals reversed. First, the court held the deed unambiguous and construed the scope of the conveyance to encompass only a $\frac{1}{32}$ nd *fractional share* non-participating royalty. In effect, the court determined that the deed conveyed to Lindsey a *fractional share* $\frac{1}{32}$ nd royalty, not a $\frac{1}{4}$ th *fraction of* royalty. Thus, Lindsey was only entitled to a $\frac{1}{32}$ nd share of gross production regardless of the size of the landowner's royalty contained in the 1973 lease. The court observed:

The Plaintiff became entitled to a $\frac{1}{32}$ nd royalty interest, but no more. That interest was established in 1935 and was absolute and independent of any royalty reserved in any future lease by the then holder of the executive rights.³⁰

In effect, the court in *Canter* literally interpreted the $\frac{1}{4}$ th of $\frac{1}{8}$ th royalty deed to convey a *fractional share* $\frac{1}{32}$ nd interest.

In addition to the 1935 deed, Lindsey also claimed that the recitals in the 1941 Mabee deed that described, albeit erroneously, his royalty share as a $\frac{1}{4}$ th of royalty established his right to a $\frac{1}{4}$ th share of the 1973 lease royalty. The court rejected this argument for the following reasons. First, the recitals in the Mabee deed that described the royalty as a $\frac{1}{4}$ th share did not operate to grant Lindsey that interest because the Mabee deed lacked words of conveyance. Additionally, because the recitals in the Mabee deed were erroneous as to Lindsey's title, the recitals could not supply a basis for an exception to the grant that would operate as a conveyance of an interest.³¹ Finally, both of the Lindsey theories relating to the 1941 Mabee deed failed because they contravened the rule that a reservation in favor of a stranger to the title is void.

Mabee, the grantee to the 1941 deed, claimed the excess royalty at issue on the theory that Roberts had conveyed to him everything which she owned and had not previously conveyed to Lindsey. The court rejected this argument noting that even though Roberts was mistaken as to Lindsey's

Roberts, the intervenor, claimed $\frac{1}{4}$ th of any royalty in excess of $\frac{1}{8}$ th reserved on any lease ($\frac{1}{4}$ th of $\frac{1}{16}$ th, or $\frac{1}{64}$ th). She recognized that Lindsey was entitled to $\frac{1}{32}$ nd of gross production and Mabee was entitled to $\frac{3}{4}$ ths of $\frac{3}{16}$ th or $\frac{9}{64}$ ths of gross production.

30. *Canter*, 575 S.W.2d at 335.

31. See *Pich v. Lankford*, 302 S.W.2d 645 (Tex. 1957), which was cited in *Canter*, 575 S.W.2d at 335.

interest under the 1935 deed, believing Lindsey owned a $\frac{1}{4}$ th of royalty when he in fact owned a $\frac{1}{32}$ nd royalty, the 1943 deed clearly and unambiguously reserved a $\frac{1}{4}$ th of the royalty from the conveyance to Mabee. In effect, Roberts retained that portion of the reserved interest that was not outstanding in another.³² Thus, as only $\frac{1}{32}$ nd was outstanding in Lindsey, entitling him to $\frac{2}{64}$ ths of the gross production, and Roberts had reserved $\frac{1}{4}$ of royalty in the conveyance to Mabee, being $\frac{1}{4}$ th of $\frac{3}{16}$ ths, or $\frac{3}{64}$ ths, of such production, she owned the difference, being a $\frac{1}{64}$ th share of gross production.

When *Canter v. Lindsey* is considered in relation to Dean Smith's general intent theory, one wonders if Dora Roberts believed that a $\frac{1}{4}$ th of $\frac{1}{8}$ th royalty was identical to a $\frac{1}{4}$ th of royalty when she executed the two deeds. The court admitted that Roberts was mistaken as to the effect of the 1935 deed when she executed the 1941 deed. Was she also mistaken in believing that a $\frac{1}{4}$ th of $\frac{1}{8}$ th royalty was conveyed to Lindsey, as opposed to a $\frac{1}{4}$ th of royalty? Or did she simply not believe that there was a distinction between the two? Did she think that the different formulas were synonymous and conveyed the equivalent share in production from a future lease? Roberts, as well as Lindsey and Mabee, may have labored under that delusion. In any event, no matter how convincing one might find Smith's theory, the literal interpretation that results from a *fractional share* construction of a fraction of $\frac{1}{8}$ th royalty prevails, absent additional language or circumstances that dictate a different result.³³ The plain

32. The court noted that Roberts conveyed a $\frac{3}{4}$ th mineral interest to Mabee. As to the remaining $\frac{1}{4}$ th mineral interest, Roberts conveyed to Mabee the executive right and the right to bonus and delay rentals. Thus, Roberts owned the $\frac{1}{4}$ th mineral interest shorn of the executive right, right to delay rentals, right to bonus, and a $\frac{1}{8}$ th of royalty. Note that despite the fact that Roberts conveyed most of the incidents of ownership as to her $\frac{1}{4}$ th non-participating mineral estate, she would only share in any benefits of mineral ownership in the event that the lease royalty was in excess of $\frac{1}{8}$ th.

33. In *Remuda Oil Co. v. Wilson*, 264 S.W.2d 192 (Tex. Ct. App. 1954), the court construed a royalty deed that granted a $\frac{1}{4}$ th of non-participating royalty as conveying only a $\frac{1}{4}$ th of $\frac{1}{8}$ th royalty. Following the legal description, the $\frac{1}{4}$ th of royalty deed contained a clause referring to a prior deed "for all purposes." The prior deed was the source of the grantor's title that reserved to the grantor only an "undivided $\frac{1}{2}$ of $\frac{1}{8}$ th royalty." Subsequently, an oil and gas lease was executed providing for a variable royalty, a $\frac{1}{4}$ th royalty that under certain circumstances would increase to a $\frac{7}{16}$ ths royalty. The holding that the $\frac{1}{4}$ th of royalty deed conveyed only a $\frac{1}{4}$ th of $\frac{1}{8}$ th royalty was based on the following factors: (1) the usual lease royalty is a $\frac{1}{8}$ th royalty share and (2) it would be unjust to construe the deed to convey a $\frac{1}{4}$ th of royalty when the grantor only owned a $\frac{1}{2}$ of $\frac{1}{8}$ th royalty, which was less than a $\frac{1}{4}$ th of royalty share to the potential $\frac{7}{16}$ th lease royalty. Therefore, the reference to the prior deed "for all purposes" referred to the $\frac{1}{2}$ of $\frac{1}{8}$ th royalty

language of the formula evidences the specific intent that cannot be overridden by a general intent derived from the historical background of the universality of the $\frac{1}{8}$ th lease royalty and a general assumption that the fraction $\frac{1}{8}$ th was intended to encompass any *fraction of* lease royalty.

B. The Inconsistent Granting Clause: A Fraction Of and the Minimum Royalty Provision

*Brown v. Havard*³⁴ involved the construction of the following royalty reservation contained in a 1963 warranty deed:

Grantors reserve . . . in perpetuity an undivided one-half non-participating royalty (Being equal to, not less than an undivided $\frac{1}{16}$ th)³⁵

Brown, the defendant, executed the deed in favor of the predecessors-in-interest of the plaintiffs, Havard, et al. (Havard). The land was then subject to an oil and gas lease providing for a $\frac{1}{8}$ th royalty that was held during the secondary term by payment of shut-in-gas royalties on a gas well, the Gill No. 1. In 1973, Havard executed an oil and gas lease to M-Tex that provided for a $\frac{3}{8}$ th lease royalty and covered the entire tract except for the Gill No. 1 gas unit. M-Tex drilled four producing wells on the new lease.

Havard brought a declaratory judgment action contending that Brown only reserved a $\frac{1}{16}$ th royalty in the M-Tex wells.³⁶ Havard argued, *inter*

share owned by the grantor and disclosed the intention to convey to the grantee $\frac{1}{4}$ th of that $\frac{1}{8}$ th royalty.

Remuda illustrates the converse case. In *Remuda*, a $\frac{1}{4}$ th of royalty was construed as a $\frac{1}{4}$ th of $\frac{1}{8}$ th royalty. However, this decision represents an instance in which additional language in a deed results in an interpretation of a *fractional share* or *fraction of* royalty that differs from the traditional construction.

34. 593 S.W.2d 939 (Tex. 1980).

35. *Id.* at 940.

36. The royalty to be paid on the pre-existing gas well was also an issue. Havard alleged that Brown was only entitled to $\frac{1}{16}$ th of the proceeds from the gas well. Brown contended that he was entitled to $\frac{1}{2}$ of the gross production from the gas well and $\frac{1}{2}$ of the $\frac{3}{8}$ ths royalty from the M-Tex wells. The jury, based on extrinsic evidence, held that Brown was entitled to $\frac{1}{16}$ th of the production from any well. The trial judge found the deed unambiguous and entered a judgment notwithstanding the verdict (JNOV). The trial judge determined that Brown was entitled to $\frac{1}{2}$ of the production from the gas well and $\frac{1}{2}$ of the $\frac{3}{8}$ ths royalty from the M-Tex lease. *Id.* at 941.

The court on appeal held the deed was ambiguous, in part, because Brown was awarded $\frac{1}{2}$ of gross production from the gas well but only $\frac{1}{2}$ of the $\frac{3}{8}$ ths royalty from the M-Tex wells. *Id.* at 944. The dissent rejected the view that the difference in the trial judge's award as to the share of production from the gas well and the oil wells could be a basis for finding

alia, that the deed was ambiguous and that extrinsic evidence revealed that the parties only intended a reservation of a $\frac{1}{16}$ th royalty. Brown contended that the deed was unambiguous and reserved $\frac{1}{2}$ of royalty, entitling him to $\frac{1}{2}$ of the $\frac{3}{8}$ ths lease royalty.

The case was tried to a jury which found, based on extrinsic evidence, that Brown was only entitled to a $\frac{1}{16}$ th share of gross production. The trial judge, who found the deed was not ambiguous and that it reserved a $\frac{1}{2}$ of royalty, entered a judgment notwithstanding the verdict (JNOV) and awarded Brown an undivided of the lease royalty, being $\frac{3}{16}$ ths of gross production.

The Texas Court of Civil Appeals reversed. The court found the deed ambiguous and determined that the evidence supported the jury's determination that the parties intended only a reservation of a $\frac{1}{16}$ th royalty. The Supreme Court of Texas, in a divided opinion, affirmed the appeals court.

The majority of the Texas Supreme Court held the deed was ambiguous, thus permitting the admission of extrinsic evidence to ascertain the intent of the parties. To determine whether a deed is ambiguous, a court applies established rules of interpretation. If the deed remains susceptible to more than one interpretation, it is ambiguous. If only one meaning is clearly evident, the deed is not ambiguous.

The majority predicated its decision that the reservation was ambiguous on the following construction. The deed provided:

Grantors reserve . . . in perpetuity an undivided one-half non-participating royalty³⁷

The majority determined this language would reserve a $\frac{1}{2}$ royalty, being $\frac{1}{2}$ of gross production, and not $\frac{1}{2}$ of the royalty. However, the parenthetical phrase, "Being equal to, not less than an undivided $\frac{1}{16}$ th," had "reference to a reservation *of* royalty."³⁸

The parenthetical phrase contained the ambiguity. One interpretation of the language "Being equal to, not less than an undivided $\frac{1}{16}$ th" was that it

ambiguity. *Id.* at 945. Instead, the dissent noted that Havard was the operator and owner of the gas well and, more importantly, the judge's verdict as to the $\frac{1}{2}$ share of gross production from the gas well was derived from a pre-trial stipulation made by the parties that agreed to that division of the production from that well. Based upon the stipulation as to the division of the gas well production, my analysis of the case will only consider the issue as to the division of the $\frac{3}{8}$ ths M-Tex lease royalty in order to facilitate and simplify the discussion.

37. *Id.*

38. *Id.* at 942.

reserved a $\frac{1}{16}$ th *fractional share* royalty. In effect, this interpretation leads to the conclusion that the parties intended to reserve a $\frac{1}{2}$ of the conventional $\frac{1}{8}$ royalty, “being equal to” a $\frac{1}{16}$ th royalty. Under this interpretation, the language “not less than an undivided $\frac{1}{16}$ th” merely provided for the contingency that if the lease royalty were ever reduced, the $\frac{1}{16}$ th share would be received, insuring the reservation was a $\frac{1}{2}$ of $\frac{1}{8}$ th royalty.

The parenthetical phrase also supported an alternative interpretation of a reservation of $\frac{1}{2}$ of royalties contained in future leases with a proviso that such share could not be less than $\frac{1}{16}$ th. This was the argument advanced by Brown. However, the opinion cryptically noted that the presence of the “comma” between the phrase “being equal to” and “not less than an undivided $\frac{1}{16}$ th” must be ignored to permit this latter construction. In other words, in the view of the majority, the presence of the “comma” in the parenthetical phrase grammatically precluded construing that language as intending to convey a $\frac{1}{2}$ of royalties in future leases but not less than a $\frac{1}{16}$ th share. To achieve that construction based on that language, the comma or the grammatical construction must be ignored.³⁹ After reviewing the extrinsic evidence admitted by the trial court, the majority affirmed the Texas Court of Appeals’ determination that Brown intended to reserve a $\frac{1}{16}$ th royalty share.

The dissenting opinion found the deed unambiguous and reserved to Brown $\frac{1}{2}$ of royalties with a minimum royalty set at $\frac{1}{16}$ th. The dissent interpreted the parenthetical language as referring to the lease in existence at the time the deed was executed *as well as* to future leases. Under the existing lease, which had a $\frac{1}{8}$ th royalty clause, a reservation of $\frac{1}{2}$ of royalties would be equivalent to a $\frac{1}{16}$ th royalty. The inclusion of the words “not less than an undivided $\frac{1}{16}$ th” only indicated that Brown contemplated

39. The specific language of the majority opinion on the possible construction of the parenthetical phrase, “being equal to, not less than an undivided $\frac{1}{16}$ th,” is as follows:

The parenthetical language itself is subject to more than one interpretation. One interpretation is that the parties intended to reserve $\frac{1}{2}$ of the conventional $\frac{1}{8}$ th royalty, “being equal to” a $\frac{1}{16}$ th. The additional phrase “not less than” insured that the reservation was $\frac{1}{2}$ of the conventional $\frac{1}{8}$ th royalty, and if the royalty were reduced, the Browns would still receive their $\frac{1}{16}$ th. On the other hand, the parenthetical language can be construed, as urged by the Browns, to reserve $\frac{1}{2}$ of the royalties contained in future leases, providing further that the share must not be less than $\frac{1}{16}$ th. Such construction must ignore the presence of the “comma” between the phrase “Being equal to” and the phrase “not less than an undivided $\frac{1}{16}$ th.”

Brown, 539 S.W.2d at 942.

future leases on the property after the existing lease expired. In the event a future lease provided for less than a $\frac{1}{8}$ th royalty, Brown would still be entitled to a $\frac{1}{16}$ th royalty under the parenthetical clause. If the future lease provided in excess of a $\frac{1}{8}$ th royalty, Brown was to share in $\frac{1}{2}$ of that royalty. The dissent's view, in effect, was that the draftsman was merely exercising caution to guarantee a certain minimum royalty.

Additionally, the dissent differed on the effect of the "comma" in the parenthetical phrase. The dissent noted:

There is no language anywhere in the reservation clause to indicate that the Browns' royalty was to be limited to a maximum of $\frac{1}{16}$ th: there is no language to the effect that $\frac{1}{2}$ of royalties is to be equal to *not more than* $\frac{1}{16}$ th. The reservation does, however, unambiguously state that the Browns' royalty interest is to be *not less than* $\frac{1}{16}$ th. Describing a variable amount as being equal to not less than $\frac{1}{16}$ has the same result as describing it as equal to or greater than $\frac{1}{16}$. The absence of a comma between the words "equal to" and "not less than" does not change this meaning. The deed reserves $\frac{1}{2}$ of royalties, and the explanatory parenthetical sets a minimum of $\frac{1}{16}$. The specific fractional equivalent to $\frac{1}{2}$ of royalties may vary according to the lease so long as the Browns received their $\frac{1}{16}$ minimum.⁴⁰

Brown v. Havard illustrates some of the perplexing problems encountered by lawyers and laypersons when construing mineral or royalty conveyances. Initially, one must be able to see the deed's or reservation clause's potential for ambiguity and susceptibility to different interpretations. However, as noted by the *Havard* majority opinion, even if a deed or reservation clause is susceptible to two constructions, it is not ambiguous if one construction clearly predominates.

More importantly, the conclusion that the reservation is ambiguous may be plausible but not irresistible. After all, in *Havard*, the grantor's reservation expressly specified a $\frac{1}{2}$ non-participating royalty which was intended as a $\frac{1}{2}$ of royalty reservation. *Havard* never argued otherwise. This specific reservation was followed by the parenthetical phrase in which the majority found the ambiguity. When the reservation was created, an oil and gas lease with a $\frac{1}{8}$ th royalty was in existence and the grantor could have intended to reserve a perpetual non-participating royalty, mindful at the time that future leasing of the tract may occur. The grantor's intent appears

40. *Id.* at 946.

evident: the language of the parenthetical phrase was to insure that no less than a $\frac{1}{8}$ th lease royalty would ever devalue the grantor's perpetual royalty interest. Did the grantor also intend the language "Being equal to" to confine his royalty share to a $\frac{1}{16}$ th? What would your answer be if you did not know that the jury had found that the parties intended the reservation of a $\frac{1}{16}$ th share of production?⁴¹

If in fact Brown's intent was to reserve a $\frac{1}{2}$ of royalty interest, adding the parenthetical phrase only to insure that his royalty under any future lease would be a minimum of $\frac{1}{16}$ th share, then the minimum royalty provision that was drafted and designed to protect, in actuality, led to ruination. Although minimum royalty provisions may be a desirable addition to the *fraction of* royalty grant or reservation in order to protect the royalty owner from a low lease royalty negotiated by the executive owner, *Havard* points out the necessity that such clauses be clearly and unambiguously drafted so that the conveyance is to a *fraction of* royalty with a minimum royalty limitation. Otherwise, as may have been the case in *Havard*, that which was intended to help may in fact harm.

C. The Horrors of the Double Fraction

In *Palmer v. Lide*,⁴² the Arkansas Supreme Court was construing a 1927 non-participating royalty deed that granted as follows:

do hereby grant, bargain, sell and convey . . . an undivided one-eighth of one-eighth ($\frac{1}{8}$) interest in and to all of the oil gas and other mineral royalty⁴³

Oil production was subsequently established on the land under a lease providing for a $\frac{1}{8}$ th landowner's royalty. Division orders were prepared which reflected that the deed conveyed a $\frac{1}{8}$ th of $\frac{1}{8}$ th royalty, a $\frac{1}{64}$ th share of gross production. The successors-in-interest of both the grantors (plaintiffs) and the grantees (defendants) executed the division orders and royalty was distributed to the parties on that basis until the operator suspended the amount subsequently disputed. Plaintiffs then sued to recover the suspended royalties and to determine their proper share of future royalties.

The plaintiffs argued that the deed conveyed a $\frac{1}{8}$ th of $\frac{1}{8}$ th of royalty, with the latter being fixed by the lease at $\frac{1}{8}$ th. Thus, according to the

41. This is the pithy question posed by Dean Smith in his analysis of *Havard*. See Smith I, *supra* note 11, at G-4. The present author relies heavily on Smith's analysis.

42. 567 S.W.2d 295 (Ark. 1978).

43. *Id.*

plaintiffs, the deed conveyed $\frac{1}{8}$ th of $\frac{1}{8}$ th of $\frac{1}{8}$ th, being a $\frac{1}{512}$ th share of gross production. The defendants argued that the deed, as reflected in the original division orders, conveyed $\frac{1}{8}$ th of $\frac{1}{8}$ th royalty, being a $\frac{1}{64}$ th production share. The Arkansas Supreme Court, affirming the trial court, interpreted the deed as conveying $\frac{1}{8}$ th of $\frac{1}{8}$ th of the royalty, which under the facts was a $\frac{1}{512}$ th share of gross production. Predictably, the court gave effect to the plain language of the grant. The language unequivocally conveyed a fraction ($\frac{1}{8}$) of a fraction ($\frac{1}{8}$) of a fraction (of royalty, being a $\frac{1}{8}$ th share). The court observed that it simply “is not possible to interpret the unmistakably clear language of the deed to mean $\frac{1}{8}$ th of $\frac{1}{8}$ th of the total production.”⁴⁴

The defendants, who had been enjoying the royalty overpayment occasioned by the inaccurate division orders, also argued vainly that the plaintiffs were barred from claiming that the defendants were only entitled to receive a $\frac{1}{512}$ th production share by adverse possession, laches, limitations or estoppel. The court, following *Warmack v. Cross Co.*,⁴⁵ held that the overpaid royalty owner did not acquire title by adverse possession or acquiescence to the interest attributed to his ownership by a mistake of the party who disbursed the proceeds of production. In addition, the court held that one who erroneously received and kept overpayment for several years was not in equity entitled to a continuation of the error.

One cannot quarrel with the construction of the “double fraction” formula by the Arkansas Supreme Court in *Lide* and by other courts.⁴⁶ The specific intent of the parties, arising from the plain language of the formula, was unmistakable.

However, one is haunted by the fear that the “horrors of the double fraction” may be the result of an error based simply on the parties’ selection of the wrong royalty deed form. Perhaps intending only to convey a $\frac{1}{8}$ th of $\frac{1}{8}$ th royalty, equal to a $\frac{1}{64}$ th share of gross production, the parties mistakenly selected a printed form to convey a *fraction of* royalty and inserted in the blank the fraction $\frac{1}{8}$ th of $\frac{1}{8}$ th which was followed in the form by the salient *of royalty* language. Had the printed form selected been for a *fractional share* conveyance, no mistake would have occurred and the parties’ intent would have been effectuated.

Obviously, that one simple and single word “of,” succeeded by the term “royalty,” was paramount in establishing the portion of the royalty share

44. *Id.* at 296.

45. 377 S.W.2d 47 (Ark. 1946).

46. *Harris v. Ritter*, 279 S.W.2d 845 (Tex. 1955); *Richardson v. Hart*, 185 S.W.2d 563 (Tex. 1945).

conveyed. Yet that simple distinction was probably lost on many landowners, particularly in the early days of mineral conveyancing. That common error, like the *Duhig* rule of mineral conveyancing,⁴⁷ has likely occasioned the loss of fortunes in oil and gas royalties.

D. The Large Fractional Share

Fractional share non-participating royalties are peculiarly worthy of caution. The illustrative case is *Gavenda v. Strata Energy, Inc.*,⁴⁸ a Texas Supreme Court case, wherein the Gavenda family reserved a 15-year non-participating royalty interest in a 1967 deed. The relevant part of the deed provided:

an undivided one-half ($\frac{1}{2}$) non-participating royalty of all of the oil and gas in, to and under that [sic] produced⁴⁹

Subsequently, in 1978, the predecessor-in-interest to the grantee, who owned the executive right to the Gavendas' non-participating royalty, executed an oil and gas lease providing for a $\frac{1}{8}$ th landowner's royalty. Thereafter, Strata Energy, Inc. and others acquired the oil and gas lease by assignment and drilled two producing wells on the tract.⁵⁰

47. For a discussion of the *Duhig* rule of mineral conveyancing, see Willis H. Ellis, *Rethinking the Duhig Doctrine*, 28 ROCKY MT. MIN. L. INST. 947 (1982).

48. 705 S.W.2d 690 (Tex. 1986).

49. *Gavenda*, 705 S.W.2d at 690.

50. *Arnold v. Ashbel Smith Land Co.*, 307 S.W.2d 818 (Tex. Ct. App. 1957), provides another example of a large *fractional share* royalty. The case involved the construction of a reservation of a 49 year term royalty in which the first clause provided:

Grantor expressly reserves unto itself, its successors and assigns, a one-fourth royalty in all oil, gas and other minerals in and under or hereafter produced . . .

Id. at 820.

The last clause of the reservation indicated that the grantor's reservation was non-participating as to the executive right, bonus, and delay rentals. At the end of this clause was the following language:

but if oil, gas or other minerals be produced in commercial quantities, then Grantor, . . . shall, during the term and existence of such reserved royalty, have and receive one-fourth part of such oil, gas and other minerals so produced as a royalty.

Id. (emphasis added).

The successors-in-interest of the grantees, the plaintiffs, argued that the reservation created a $\frac{1}{4}$ th *fraction of* royalty, as opposed to a $\frac{1}{4}$ th *fractional share* royalty. Plaintiffs argued that if a "comma" were inserted after the language "so produced" and before the language "as a royalty," then the words "so produced" would modify "produced in commercial quantities," and the words "as a royalty" would modify "one-fourth part of such

Strata then hired an attorney to prepare a division order title opinion. The examining attorney erroneously interpreted the reservation in the 1967 deed as entitling the Gavenda family to a $\frac{1}{16}$ th royalty share, as opposed to a $\frac{1}{2}$ royalty share. Obviously, the attorney erroneously construed the reservation as a $\frac{1}{2}$ of royalty, accruing $\frac{1}{2}$ of the landowner's royalty equal to a $\frac{1}{64}$ th of gross production. Instead, the deed reserved a royalty which entitled the Gavendas' to a $\frac{1}{2}$ of gross production.

Based on the title opinion, Strata prepared division orders, which the Gavendas' executed, that provided for the disbursement of their share of the proceeds on a $\frac{1}{16}$ th royalty share. Thereafter, when members of the Gavenda family died and the royalty ownership changed, transfer orders were prepared and executed reflecting the $\frac{1}{16}$ th royalty ownership.

Apparently, during the administration of one of the estates, the error was discovered. The Gavendas' revoked their division and transfer orders two days before the term interest expired. Thereafter, the Gavendas' sued to recover the unpaid $\frac{7}{16}$ th royalty share, amounting to more than \$2.4 million in unpaid royalties. In the litigation, the defendant lessees did not dispute that the deed reserved a $\frac{1}{2}$ royalty interest, equal to a $\frac{1}{2}$ share of gross production. Instead, they argued that the stipulation of ownership interest contained in the division orders estopped the plaintiffs from claiming any royalty in excess of the $\frac{1}{16}$ th interest.

The Supreme Court of Texas, reversing the trial court and the intermediate appellate court,⁵¹ held that the defendants were liable for the unpaid royalties prior to the revocation of the division orders. Historically, estoppel had been applied based on the stipulation of ownership interest contained in the division order. Estoppel precluded the underpaid interest owner from recovering the deficiency from the operator who relied on the division order to distribute the proceeds of production.⁵² The court

oil, gas and other minerals." Thus, the construction would be " $\frac{1}{4}$ th royalty part of production," or a $\frac{1}{4}$ th of royalty.

The court observed that the "comma" could be inserted if necessary to arrive at the intent of the parties. However, the court determined that when read along with the entire reservation, the language at issue was clear and unambiguous. As to the grammatical construction, the court noted that the words "so produced" and "as a royalty" followed the same sequence as their respective antecedents. Further, the court explained that if the grantors were only to receive " $\frac{1}{4}$ th of royalty," there would be no reason for the inclusion of the article "a" that immediately preceded the word "royalty." Therefore, a $\frac{1}{4}$ th fractional share royalty was reserved.

51. 683 S.W.2d 859 (Tex. Ct. App. 1984), *rev'd in part*, 705 S.W.2d 690 (Tex. 1986).

52. The division order has historically authorized the purchaser of production, or the operator who disburses the proceeds of production, to receive the production and to

reasoned, however, that estoppel was not applicable when the operator made the error because a contrary result would allow the operator to profit unjustly from the operator's own mistake.

The court's holding recognized that the attorney who misconstrued the royalty reservation was being sued for malpractice but, as the attorney was the agent of the defendants, his negligence was imputed to them.

E. Inconsistency in the Granting, Subject To and Future Leasing Clauses

Paralleling early mineral deeds, early non-participating royalty deed forms and, occasionally, formally drafted royalty reservations often contained multiple clauses in which different fractions could be inserted. The granting clause designates the portion of the estate conveyed in the deed. The designated "subject to" clause often recites that the interest conveyed was subject to an outstanding oil and gas lease and specifies the lease benefits that are covered and included in the grant.⁵³ The "future-lease" clause specifies the ownership interests that will be conveyed under future leases after the existing lease has expired.⁵⁴

distribute the proceeds from the sale pursuant to the specified division of interest. Traditionally, if the proceeds are distributed pursuant to the division of ownership interest specified in the executed division order, an interest owner is estopped to assert a claim against the purchaser or operator for an inadequate payment. *Dale v. Case*, 64 So. 2d 344 (Miss. 1957); *Exxon Corp. v. Middleton*, 613 S.W.2d 240 (Tex. 1981). See also 4 WILLIAMS & MEYERS, *supra* note 4, § 704.5 for citations to other authorities.

In *Gavenda v. Strata Energy, Inc.*, 705 S.W.2d 690 (Tex. 1986), the Supreme Court of Texas held that the estoppel arising from reliance on the division of ownership interest specified in the division order only precludes liability when the overpayment is made to a third-party and is not retained by the party disbursing the proceeds of production.

53. The "subject to" and "future lease" clauses, and the problems of interpretation resulting from conflicting fractions appearing in the various clauses, have been the subject of a number of law review articles. Included in the following cites are articles containing an analysis of the Texas cases and the infamous "two grant" or "multiple grant" constructions. See Laura H. Burney, *The Regrettable Rebirth of the Two-Grant Doctrine in Texas Deed Construction*, 34 S. TEX. L.J. 73 (1993); Tevis Herd, *Deed Construction and the "Repugnant to the Grant" Doctrine*, 21 TEX. TECH. L. REV. 635 (1990); Bruce Kramer, *The Sisyphean Task of Interpreting Mineral Deeds and Leases*, 24 TEX. TECH. L. REV. 1 (1993); Ernest E. Smith, *The "Subject To" Clause*, 30 ROCKY MTN. MIN. L. INST. 15-1 (1985) [hereinafter Smith II].

54. The "covers and includes" language of the "subject to" clause typically specifies that the grant "covers and includes" the share of the lease benefits that the grantee is to receive pursuant to the outstanding oil and gas lease. Often the clause contains language that indicates the interest that the grantee will own when the outstanding lease terminates and it will also specify the share of the lease benefits the grantee will receive under a "future lease." Even though the latter language is contained in the "subject to" clause, to facilitate

The practice of specifying the interests conveyed under existing and future leases in the “subject to” and “future-lease” clauses can be attributed to an early ill-fated Texas case. *Caruthers v. Leonard*⁵⁵ held that the grantee of a fractional interest in a mineral estate that was subject to a pre-existing oil and gas lease did not receive a right to his proportionate share of the benefits under the lease. *Caruthers* was obviously bad law; its holding was inconsistent with a basic common law principle of conveyancing, namely that which is not specifically reserved from the grant is conveyed. Eventually, some forty years later, *Caruthers* was overruled.⁵⁶ In the absence of *Caruthers*, a “subject to” clause is only required to prevent the grantor from breaching the covenants of title when the mineral estate conveyed is burdened by a pre-existing oil and gas lease.

Deeds drafted to require the parties to fill in the blanks in separate clauses, some of which relate to the different incidents of mineral ownership such as the “subject to” and “future-lease” provisions, are obviously susceptible to errors that present perplexing issues of judicial interpretation. The focus of our inquiry is the problem which occurs when the clauses utilize both a *fractional share* and a *fraction of royalty*. However, the resolution of this issue is often intertwined with another common problem: construing mineral conveyances that contain inconsistencies between the “subject to,” “future lease” and granting clauses occasioned by the use of disparate fractions to describe the quantum of mineral interests or lease benefits conveyed and the royalty share attributable thereto.

Disparate fractions in multiple provision deeds, which particularly plagued early conveyances, were likely a result of the widespread confusion relating to the difference in the shares of production attributable to respective mineral and royalty fractional shares. For example, a grant of a $\frac{1}{16}$ th mineral estate only entitled the grantee to $\frac{1}{16}$ th of the conventional $\frac{1}{8}$ th lease royalty, equal to a $\frac{1}{128}$ th production share. Similarly, a grant of $\frac{1}{2}$ of a mineral estate entitled the grantee to a $\frac{1}{2}$ of the conventional $\frac{1}{8}$ th lease royalty, equal to a $\frac{1}{16}$ th royalty share. Failing to fully understand this distinction, parties intending to convey $\frac{1}{2}$ a mineral estate and focusing on the $\frac{1}{16}$ th share of royalty may have erroneously inserted the $\frac{1}{16}$ th fraction in

the discussion, the “future lease” language will be treated as a separate and distinct lease provision.

55. 254 S.W. 779 (Tex. Comm. App. 1923).

56. *Harris v. Currie*, 176 S.W.2d 302 (Tex. 1943).

the granting clause drafted to convey a mineral estate, while inserting the $\frac{1}{2}$ fraction in the subject to or future lease clause.⁵⁷

57. *Heyen v. Harnett*, 679 P.2d 1152 (Kan. 1984), a 1984 Kansas Supreme Court case, best illustrates the problem. The court was construing a 1925 mineral deed in which the granting clause conveyed a $\frac{1}{16}$ th mineral estate and the subject to clause provided:

if such land is covered by a valid mineral lease, the [grantee] . . . shall have an undivided $\frac{1}{2}$ interest in the Royalties, Rentals, . . .

Id. at 1154.

The plaintiff, the successor-in-interest of the grantor, argued that the deed was unambiguous; that it conveyed a $\frac{1}{16}$ th mineral interest as specified in the granting clause; and that it only entitled the defendants, the successors-in-interest of the grantees, to an undivided $\frac{1}{16}$ th of the royalties to a subsequent lease. The plaintiff further argued that the “subject to” clause only provided for $\frac{1}{2}$ of royalties *if* the land was *then* subject to an existing oil and gas lease. Because there was no such lease, the plaintiff maintained that the contingency failed, rendering the clause inapplicable to convey any interest in royalties under subsequent leases.

In opposition, the defendant argued that the deed was ambiguous and conveyed a $\frac{1}{2}$ mineral estate entitling the plaintiff to $\frac{1}{2}$ of the royalties to be paid under the subsequent lease. Finding the deed ambiguous, and admitting extrinsic evidence that indicated that the parties had subsequently treated the conveyance as conveying a $\frac{1}{2}$ mineral estate, the court held that the deed conveyed a $\frac{1}{2}$ mineral estate. In so doing the court made the following observation:

It is not uncommon for parties to mineral deeds or reservations, where a royalty or mineral interest is conveyed or reserved subject to an existing oil and gas lease, to confuse the fractional interest conveyed or reserved.

Id. at 1158 (quoting *Shepard, Ex’x v. John Hancock Mut. Life Ins. Co.*, 368 P.2d 19, 26 (Kan. 1962)).

The court continued to note that:

[a]s the most common leasing arrangement provides for a one-eighth royalty reserved to the lessor, the confusion of fractional interests stems primarily from the mistaken premise that all the lessor-landowner owns is a one-eighth royalty. In conveying minerals subject to an existing lease and also assigning a corresponding fractional interest in the royalties received, mistake is often made in the fraction of the minerals conveyed by multiplying the intended fraction by one-eighth. Thus, if a conveyance of an undivided one-half of the minerals is intended, the parties will multiply one-half by one-eighth and the instrument will erroneously specify a conveyance of one-sixteenth of the minerals upon the assumption that one-sixteenth is one-half of what the grantor owns. An ambiguity is created because the instrument will also show that the conveyance of one-sixteenth of the minerals is meant to entitle the grantor to one-half of the royalty. Of course, an undivided one-half of the minerals is needed to carry one-half of any royalties reserved.

Id. at 1158 (quoting *Magnusson v. Colorado Oil & Gas Corp.*, 731 P.2d 577, 583–84 (Kan. 1958)).

1. The Texas Cases: The Decline, Fall and Resurrection of the Multiple Grant Construction

The legacy of some early and highly criticized Texas cases⁵⁸ that construed deeds as effectuating “two grants,” or more, continues to play a prominent yet equivocal role in the Texas case law which deals with inconsistencies between the granting, “subject to,” and “future lease” clauses in mineral and royalty deeds. Under the “two grant” approach, if the benefits conferred on the grantee in the “subject to” clause or the “future lease” clause differ from the benefits derived from the interest conveyed in the granting clause, the former clauses are construed as conveying such benefits, along with but independent of the latter clause. In effect, such a deed conveys not one but two or more grants.

If the “two grant” construction prevails, then a royalty deed with a granting clause that conveys a “ $\frac{1}{32}$ nd of the oil and gas in and under and that may be produced and saved” and a “future lease” clause that recites that the grantee owns a “ $\frac{1}{4}$ th of the royalties” under “future leases” conveys two separate and distinct interests. The two interests conveyed are a $\frac{1}{32}$ nd fractional share royalty applicable to the existing lease and a “ $\frac{1}{4}$ th of royalties” under subsequent leases. The “ $\frac{1}{4}$ th of royalties” clause would entitle the grantee to its proportionate share of royalties in the future lease in excess of the conventional $\frac{1}{8}$ th landowner’s royalty.

58. The “two grant doctrine” originated in the early Texas case of *Hoffman v. Magnolia Petroleum Co.*, 273 S.W. 828 (Tex. Comm. App. 1925), in which 90 acres in fee were severed by deed from a 366 acre tract that was subject to an outstanding oil and gas lease. The “subject to” clause in the deed provided, *inter alia*, that the grantee was to receive “ $\frac{1}{2}$ of all oil royalty and gas rental or royalty due to be paid under the terms of said lease.” *Id.* at 829 (emphasis added).

The court construed the deed as executing two conveyances. The first conveyance conveyed the 90 acre tract in fee. The second conveyance, effectuated by the “subject to” clause, conveyed $\frac{1}{2}$ of the royalties under the existing lease as to the *entire* 366 acre tract. The court reasoned that the “subject to” clause covered $\frac{1}{2}$ of the royalty from the “said lease” and was not restricted to royalties accruing from production on the 90 acre tract.

The construction in *Hoffman* has been universally condemned. The likely intent of the parties in inserting the “subject to” clause was to avoid the rule announced in *Caruthers* and to ensure that the grantee received $\frac{1}{2}$ of the rentals and royalties as to the 90 acre tract conveyed. It seems unlikely that the parties would have utilized the “subject to” clause to convey $\frac{1}{2}$ of the royalties under the entire 366 acre tract.

For a discussion of the origin and applicability of the “subject to” clause, including *Hoffman* and the “two grant” theory prior to *Luckel v. White*, 819 S.W.2d 459 (Tex. 1991), see *Smith II*, *supra* note 53. For a discussion that covers *Hoffman* and the Texas cases through *Luckel* and *Jupiter Oil Co. v. Snow*, 819 S.W.2d 466 (Tex. 1991), see *infra* notes 69–73. See also *Burney*, *supra* note 53, at 89–105 and *Kramer*, *supra* note 53, at 19–43.

Although some early Texas cases applied the “two grant” theory in some oil and gas deed construction cases,⁵⁹ the theory was not applied to cases which involved conflicting fractions in mineral or royalty deeds. Instead, the traditional “four corners” rule of construction was utilized.⁶⁰ This

59. *Richardson v. Hart*, 185 S.W.2d 563 (Tex. 1945), illustrates the applicability of the two grant doctrine. The Texas Supreme Court held, *inter alia*, that a deed with a granting clause purporting to convey a $\frac{1}{16}$ th of $\frac{1}{8}$ th mineral interest and a subject to clause reciting that it “covers and includes $\frac{1}{16}$ of $\frac{1}{8}$ of all the oil royalty” conveyed two distinct grants. *Id.* at 563–64 (emphasis added). The granting clause conveyed a $\frac{1}{16}$ th of $\frac{1}{8}$ th or a $\frac{1}{128}$ th mineral interest, and the “subject to” clause also conveyed a $\frac{1}{16}$ th of $\frac{1}{8}$ th of royalty or a $\frac{1}{1024}$ th of gross production.

The court determined that the fact that the first grant of $\frac{1}{128}$ th mineral interest, when taken in conjunction with the existence of a lease with a $\frac{1}{8}$ th landowner’s royalty would entitle the grantee to a $\frac{1}{1024}$ th share of production, an amount equal to the royalty share granted in the subject to clause, was irrelevant as to the existence of the “two grants.” Referring to the grant in the subject to clause, the court observed:

The fact that it fixes the share in the present royalties the same as would have obtained by operation of law does not lessen its force and effect as a conveyance. As is often the case such payment of royalty might have been larger or smaller than a pro rata share.

Id. at 565.

In addition to *Richardson*, the other “two grant” theory cases that appeared after *Hoffman v. Magnolia*, 273 S.W. 828 (Tex. Comm. App. 1925), are *Benge v. Scharbauer*, 259 S.W.2d 166 (Tex. 1953), and *Woods v. Sims*, 273 S.W.2d 617 (Tex. 1954), which like *Hoffman*, are factually unrelated to disparate fractions in the granting, “subject to,” or “future lease” clauses. For a discussion of these cases, see Smith II *supra* note 53; Burney *supra* note 53; Kramer *supra* note 53.

60. *Garrett v. Dils Co.*, 299 S.W.2d 904 (Tex. 1957), is viewed by some commentators as a milestone case that departed from the “two grant” theory in favor of the “four corners” rule of construction. The case involved the misconception of the difference between fractional shares of mineral and royalty interests. The granting clause purported to convey an “undivided $\frac{1}{64}$ th interest in the minerals” while the subject to clause included “ $\frac{1}{8}$ th of any royalties and $\frac{1}{8}$ th of said money rentals payable by the lessee.” The future lease clause provided the grantee would own:

one-eighth of the lease interests and all future rentals . . . , he owning one-eighth of one-eighth of all oil, gas and other minerals . . . together with one-eighth interest in all future rents.

Id. at 905. The lease in existence expired and a subsequent lease was executed that provided for a $\frac{1}{8}$ th royalty. The issue presented was whether the grantee was entitled to $\frac{1}{64}$ th of royalty or a $\frac{1}{64}$ th royalty share under the subsequent lease.

The Texas Supreme Court in a divided opinion held, *inter alia*, that the deed conveyed a $\frac{1}{8}$ th of the minerals entitling the grantee to $\frac{1}{8}$ th of the royalty, or a $\frac{1}{64}$ th royalty share. The majority construed the deed from its “four corners,” viewing all of the clauses collectively, to ascertain the intent of the parties. First, the majority noted that the granting clause purported to convey a $\frac{1}{64}$ th mineral interest. However, the “subject to” clause indicated that

approach employs conventional rules of interpretation to ascertain the parties' intent.

However, *Farmers Canal Co. v. Potthast*,⁶¹ a 1979 Texas Civil Appeals Court case, was decided under the "four corners" standard. Hindsight reveals that this decision was a harbinger of what was to come. The case dealt with the construction of a 1945 non-participating royalty deed in which the granting clause conveyed "a one-fourth ($\frac{1}{4}$ th) interest in and to all of the . . . oil royalty, gas royalty, . . ."⁶² A "future lease" clause also recited:

It is distinctly understood and herein stipulated and agreed . . . that Grantee shall only receive one-fourth ($\frac{1}{4}$ th) of the money royalty on sulphur . . . and one-fourth ($\frac{1}{4}$ th) of the one-eighth ($\frac{1}{8}$ th) royalty on oil, gas and all other minerals provided for in such lease or leases; and in the event Grantors, their heirs, or assigns, in the status of the fee owners of the minerals shall operate and develop the minerals therein, Grantee, his heirs and assigns, shall own and be entitled to receive as a free royalty an undivided one-thirty-second ($\frac{1}{32}$ nd) of all of the sulphur, oil, gas and other minerals produced, saved and sold off the premises . . .⁶³

Apparently the land was not leased until 1972, when the plaintiffs, successors-in-interest to the grantors, executed an oil and gas lease that provided for a $\frac{1}{6}$ th royalty on oil and gas. Production was established on the lease.

The plaintiffs sought a judicial determination that the deed only conveyed a $\frac{1}{4}$ th of $\frac{1}{8}$ th royalty. Naturally, the defendants, the successors-

the parties understood a $\frac{1}{64}$ th of the minerals to embrace a $\frac{1}{64}$ th royalty or $\frac{1}{8}$ th of the $\frac{1}{8}$ th royalty. The language of the "future lease" clause which provided that the grantee would own $\frac{1}{8}$ th of $\frac{1}{8}$ th of the minerals reflected the parties' intent to convey a $\frac{1}{8}$ th of the royalty under future leases. Further, the language in the latter clause which provided that the grantee acquired " $\frac{1}{8}$ th of the lease interest and future rentals" indicated that the grantee had the right to lease an undivided $\frac{1}{8}$ th interest and to receive $\frac{1}{8}$ th of the bonus and rentals. In essence, the parties intended that the grantee was to share in the same royalty under future leases as the existing lease and was conveyed a $\frac{1}{8}$ th mineral interest.

For a more detailed analysis of *Garrett* as applying the "four corners" rule of construction and, more importantly, rejecting the "two grant" theory, see Burney, *supra* note 53, at 95-106.

61. 587 S.W.2d 805 (Tex. Ct. App. 1979).

62. *Id.* at 807.

63. *Id.*

in-interest of the grantees, argued that the deed conveyed a $\frac{1}{4}$ th of royalty which entitled them to $\frac{1}{4}$ th of a $\frac{1}{6}$ th royalty share. The court held that the grantees were conveyed a $\frac{1}{4}$ th of royalty, and the defendants were entitled to a $\frac{1}{24}$ th share of gross production.

In so holding, the court recited the standard rule of deed construction, the “four corners” rule. This rule requires that the court attempt to determine the parties’ intent by considering all language appearing in the deed and by harmonizing, if possible, those provisions which appear to conflict. The court, however, also recited and applied other rules of construction. The rule construing the deed against the grantor if doubt exists as to the intention of the parties was applied by the court. Additionally, the court applied the rule indicating that if there is a “necessary repugnance” of clauses in the conveyance, the granting clause prevails. Thus, because the granting clause specified a grant of $\frac{1}{4}$ th of royalty while the future leasing clause restricted the royalty to $\frac{1}{4}$ th of $\frac{1}{8}$ th, the court determined that the granting clause prevailed and that the deed conveyed a $\frac{1}{4}$ th of royalty.

Subsequently, in 1984, the Texas Supreme Court in *Alford v. Krum*⁶⁴ adopted the “repugnancy to the grant” theory to resolve inconsistencies between the granting, subject to, and future lease clauses. The case involved the construction of a 1929 deed in which the granting clause conveyed a $\frac{1}{2}$ of $\frac{1}{8}$ th mineral interest; the “subject to” clause provided for a $\frac{1}{16}$ th of royalty under the existing lease; and the “future lease” clause provided:

in the event that the said above described lease for any reason becomes canceled or forfeited, . . . the lease interests and all future rentals on said land, for oil, gas and mineral privileges shall be owned jointly by . . . [Grantors and Grantees] . . . each owning a *one-half interest in all oil, gas and other minerals* in and upon said land, together with one-half interest in all future rents.⁶⁵

The lease in effect at the time the deed was executed had expired.

The trial court construed the deed as conveying a $\frac{1}{16}$ th mineral estate ($\frac{1}{2}$ of $\frac{1}{8}$ th). The Texas Court of Appeals, emphasizing the language of the future leasing clause, reversed the trial court and held that the deed conveyed a $\frac{1}{2}$ mineral estate. In a divided opinion, the Texas Supreme Court reversed the Texas Court of Appeals and held that the deed conveyed a $\frac{1}{16}$ th mineral estate.

64. 671 S.W.2d 870 (Tex. 1984).

65. *Id.* at 872 (emphasis added).

The majority's holding was premised on the rule of construction which states that, when irreconcilable conflict exists between the granting clause and other clauses in the deed, the granting clause prevails. The majority reasoned that when an irreconcilable conflict precludes a harmonization of internally inconsistent expressions of intent, the granting clause, which contains the "controlling language" and the "key expression of intent," prevails. Further, the majority observed that the "well established" purpose of the future lease clause was to "explain or restate" the operative effect of the grant contained in the granting clause when the present lease terminates and future leases are executed. Finally, the majority emphasized that the language of the granting clause was clear and specific while the language of the future lease clause was unclear.

The dissent, by Chief Justice Pope, offered the following analysis of the deed. The granting clause first conveyed a $\frac{1}{2}$ of $\frac{1}{8}$ th or a $\frac{1}{16}$ th mineral estate. The "subject to" clause then recognized the existence of an outstanding oil and gas lease and expressly subjected the $\frac{1}{16}$ th conveyance to the outstanding lease. The dissent then noted that the majority had also held that the deed presently conveyed the "possibility of reverter" to that $\frac{1}{16}$ th interest upon termination of the lease. Up to this point in the dissent's analysis, the dissent did not disagree with the majority.

Instead, the dissent's disagreement related to the "future lease" clause. The dissent viewed this clause as conveying a "different and a greater estate" upon termination of the outstanding lease. According to the dissent, "the ridgepole that divides the rights conveyed before reverter from those conveyed after the reversion" is the language that provides, upon cancellation of the outstanding lease, "the lease interests 'and all future rentals on said land [should] be owned jointly . . . by the grantors and grantees . . . each own[ing] a one-half interest in the oil, gas and other minerals.'"⁶⁶ The dissent further noted that there was no ambiguity in a deed that granted a $\frac{1}{16}$ th mineral estate so long as there was an outstanding lease and a $\frac{1}{2}$ mineral estate upon the lease's termination. The dissent explained that the fractions were different for a good reason.⁶⁷

Even though the deed was construed to contain "multiple grants," the dissent also emphasized the applicability of the "four corners" rule of

66. *Id.* at 874.

67. *Id.* at 875. Although the dissent did not elaborate on the "good reason," I would speculate that a $\frac{1}{16}$ th mineral estate subject to a lease that yields or may yield a $\frac{1}{16}$ th of $\frac{1}{8}$ th royalties may be of equal or greater value to an undivided $\frac{1}{2}$ mineral estate after the lease expires when prospective royalties or bonuses are speculative.

construction.⁶⁸ More important are the characteristics of these multiple grants recognized by the dissent. First, the conveyance of a mineral estate which fluctuates in size according to time was recognized by the dissent. Second, the dissent recognized the grant of an undivided $\frac{1}{16}$ th interest when the land was burdened by an outstanding lease. Third, a subsequent grant of an undivided $\frac{1}{2}$ interest when the lease expired was recognized by the dissent.⁶⁹

Two points emerge from the *Alford* decision. One is that the majority adopted the “repugnant to the grant” rule of construction. This rule provides that the granting clause prevails over the “subject to” and “future lease” provisions when an irreconcilable conflict between former and latter clauses exists. This rule has some advantages, namely simplicity of application and certainty of title. Many deeds with disparate fractions as to mineral or royalty interests arising from the inclusion of a “subject to” or “future lease” clause do present irreconcilable conflicts which are impossible to internally harmonize with the granting clause. Thus, by applying this rule, a title examiner often can determine the scope of the conveyance without resort to litigation.

The problem with resolving the issue through application of the “repugnant to the grant” rule of construction is that the result achieved may not reflect the intent of the parties. Under the “repugnant to the grant” construction, the intent is ascertained by glorifying the granting clause over another clause in the deed. In fact, the language contained in the granting clause may be less dispositive as to the intent of the parties than the language found in another clause. The reign of the *Alford* decision was short-lived, however.⁷⁰ In 1991, the Texas Supreme Court in *Luckel v.*

68. The opinion also cited and endorsed *Garrett v. Dils*, 299 S.W.2d 904 (Tex. 1957). For a discussion of *Garrett*, see *supra* note 60.

69. See Burney, *supra* note 53, at 93.

70. During its short reign, the rule was applied in two appellate cases. In *Hawkins v. Texas Oil & Gas Corp.*, 724 S.W.2d 878 (Tex. Ct. App. 1987), the granting clause conveyed a $\frac{1}{32}$ nd fractional share royalty while the “future lease” clause specified a $\frac{1}{4}$ th mineral estate. The granting clause conveyed a $\frac{1}{4}$ th of $\frac{1}{8}$ th royalty and the future lease provision specified a $\frac{1}{4}$ th mineral estate upon termination of the existing lease. The holding in *Alford* was followed and the granting clause prevailed resulting in the deed only conveying a $\frac{1}{32}$ nd royalty share. *Hawkins* provides a detailed and lucid account of the evolution of the “two grant” and “repugnancy to the grant” theories.

In *Stag Sales Co. v. Flores*, 697 S.W.2d 493 (Tex. Ct. App. 1985), the granting clause specified a $\frac{1}{2}$ of royalty while the “subject to” and “future lease” clause specified a $\frac{1}{16}$ th royalty. The subsequent oil and gas lease provided for a $\frac{1}{6}$ th landowner’s royalty. Again,

White,⁷¹ another divided opinion, reversed the “repugnancy to the grant” rule of construction and specifically overturned *Alford*.

Luckel involved the construction of a 1935 royalty deed. Mayes, the grantor, conveyed a royalty interest to Luckel by a deed in which the granting, habendum, and warranty clauses recited that a $\frac{1}{32}$ nd fractional share royalty was conveyed. The “subject to” and “future lease” clauses stated that the grantee was entitled to receive “ $\frac{1}{4}$ th of any and all royalties.”⁷² When the deed was executed, the land was subject to an oil and gas lease providing for a $\frac{1}{8}$ th royalty that subsequently expired. Many years later, the land was subject to numerous leases, some of which provided for a $\frac{1}{6}$ th royalty. A declaratory judgment action was brought to determine if the successors-in-interest of the grantee, Luckel, were entitled to a $\frac{1}{32}$ nd or a $\frac{1}{4}$ th of $\frac{1}{6}$ th share of gross production from the excess royalty clauses.

The majority opinion applied the “four corners” rule of construction. This rule requires the court to ascertain the intent of the parties by attempting to harmonize all parts of the deed and to only strike down a part of the deed when its effect is destroyed by an irreconcilable conflict with another part of the instrument. The *Luckel* majority ascertained the parties’ intent by harmonizing the conflict between the granting clause and the “future lease” clause. The court accomplished this by determining that the granting clause conveyed a $\frac{1}{32}$ nd interest (or $\frac{1}{4}$ th of the royalty under the existing lease) until the existing lease expired and that the “future lease” clause presently conveyed the possibility of reverter as to $\frac{1}{4}$ th of royalties. Thus, as to future leases, the latter clause conveyed a $\frac{1}{4}$ th of the total reserved royalty. Because the harmonization of the Mayes-Luckel deed conflicted with the construction of the deed in *Alford*, the latter case was expressly overruled. The court further held that the outright grant of a $\frac{1}{32}$ nd fixed royalty in the granting clause did set the minimum of the royalty for the $\frac{1}{4}$ th royalty conveyed pursuant to the “future lease” clause.

following *Alford*, the granting clause prevailed. Thus, the deed conveyed a $\frac{1}{2}$ of royalty entitling the grantees to a $\frac{1}{12}$ th production share.

71. 819 S.W.2d 459 (Ark. 1991).

72. The deed also contained a clause that recited that it was “understood . . . that Mayes is the owner of one-half of the royalties to be paid under the terms of the present existing lease, the other one-half having been previously transferred by her to her children, and by the execution of this instrument, . . . Mayes conveyed one-half of her one-sixteenth ($\frac{1}{16}$ th) royalty now reserved by her.” *Id.* at 461.

Luckel v. White resurrected the “two grant” doctrine in Texas deed construction.⁷³ Although the language of the “four corners” rule of construction which requires the court to harmonize all clauses of the instrument if possible was present in the court’s opinion, the *Luckel* court’s recognition of and emphasis on the two separate and distinct grants emerging from the granting clause and the “future lease” clause is inescapable. The court determined that because the granting clause conveyed a $\frac{1}{32}$ nd fractional royalty share under the existing lease and the “future lease” clause conveyed a $\frac{1}{4}$ th of royalty as to the possibility of reverter which would become possessory apparently upon the execution of the future lease, a conveyance of simultaneous interests occurred.⁷⁴ The

73. The conclusion that *Luckel v. White* represents a return to the “two grant” mode of construction by the Texas Supreme Court is reinforced by *Jupiter Oil Co. v. Snow*, 819 S.W.2d 466 (Tex. 1991), a case decided the same day as *Luckel*. There, the issue involved the construction of a 1918 mineral deed that had been executed when the land was then subject to an oil and gas lease providing for a $\frac{1}{8}$ th royalty. The deed contained a granting clause conveying a $\frac{1}{16}$ th mineral interest and a “future lease” clause that provided, *inter alia*, that if the existing lease terminated without production, the grantee herein or his assigns “are to have . . . under this conveyance an undivided $\frac{1}{2}$ of all the oil. [sic] gas or other mineral . . . and it is the intention of the grantors herein that in the event said lease is forfeited, then in that event the grantee is to have and hold an equal undivided one half of all such minerals.” *Id.* at 468. Apparently, the lessee drilled a producing well on the assumption that the deed only conveyed a $\frac{1}{16}$ th mineral interest and the accounting as to a cotenancy would only be on a $\frac{1}{16}$ th net profits basis.

The plaintiffs, the successors-in-interest to the grantee, argued that the deed conveyed a $\frac{1}{2}$ mineral interest and sought an accounting on a $\frac{1}{2}$ net profits basis. The court of appeals affirmed the judgment of the trial court and applied *Alford*, holding that the deed, pursuant to the granting clause that controlled the inconsistent “subject to” clause, only conveyed a $\frac{1}{16}$ th mineral interest. The Texas Supreme Court reversed and held that the granting clause conveyed a $\frac{1}{16}$ th mineral interest while the “subject to” clause simultaneously conveyed a $\frac{7}{16}$ th interest in the possibility of reverter in the mineral estate. Thus, when the existing lease expired, the grantee owned a $\frac{1}{2}$ fee mineral estate. As a result, the lessee had to account on a $\frac{1}{2}$ net profits basis. Although noting that the case had been overruled in *Luckel*, the court in *Jupiter Oil* distinguished *Alford* on the basis that the deed in *Jupiter Oil* unambiguously granted a $\frac{1}{16}$ th fee mineral interest and a $\frac{7}{16}$ ths interest in the possibility of reverter to the mineral estate.

To fully comprehend the “two grant” analysis, *Jupiter Oil* should be compared with *Heyen v. Harnett*, 679 P.2d 1152 (Kan. 1984), wherein the Kansas Supreme Court reached the same result on a different theory. For a discussion of *Heyen*, see *supra* note 57.

74. The court opined that the only difference between the deed in *Alford* and the deed in *Luckel* was that the former was a mineral deed while the latter was a royalty deed and that this distinction was immaterial. Thus, deeds involving disparate mineral and royalty fractions are to be construed by the *Luckel* standard. *Luckel*, 819 S.W.2d at 463.

interests differed only as to the share conveyed and the time in which the interests were to become possessory.

This determination is a rather sophisticated theory as to the intent of the parties to a 1935 royalty deed. The criticism of *Luckel v. White*, which is the enduring criticism of the “two grant” theory, is that it is unlikely the parties intended two separate grants in the deed. As stated by the dissenting opinion:

The oft-repeated expression that a grantor has the power to convey by one instrument different interests in the possibility of reverter and under the subsisting lease should not obscure the fact that very few grantors really intend to convey interests of different magnitude.⁷⁵

The flawed theory of *Luckel* does not necessarily make the result wrong. The effect is the same as if the deed had been construed against the grantor. However, the dissent disagreed with the result as well as the “two grant” rationale. The dissent would have taken judicial notice of the fact that the standard lease royalty in 1935 was a $\frac{1}{8}$ th share. Thus, the parties did not then contemplate that a $\frac{1}{4}$ th of royalties might not always equal a $\frac{1}{32}$ nd production share. The granting clause intended to convey a permanent grant of a $\frac{1}{32}$ nd royalty interest. Under this view, the “future lease” clause’s “ $\frac{1}{4}$ th of royalties” was used only to extend the $\frac{1}{32}$ nd production share to future leases.

Despite the lack of enthusiasm for the resurrection of the “two grant” doctrine to mineral and royalty conveyances, no one mourned the loss of *Alford*, except of course title examiners who determined ownership on the basis of the “repugnancy to the grant” theory and their clients who made investments in mineral and royalty titles in reliance on *Alford*.

2. *The Arkansas Cases*

Barret v. Kuhn,⁷⁶ is the first Arkansas Supreme Court case construing a non-participating royalty deed that contained both a *fractional share* and a *fraction of royalty*. The royalty deeds at issue were executed in the 1940’s when there was no production on the land. The deeds were titled “Royalty Deeds.” The term “non-participating” was printed underneath the title. The granting clause provided:

75. *Luckel*, 819 S.W.2d at 466. The dissent was quoting from 2 WILLIAMS & MEYERS, *supra* note 4, § 340.2.

76. 572 S.W.2d 135 (Ark. 1978).

do hereby grant . . . an undivided one sixty-fourth ($\frac{1}{64}$) interest in and to all of the oil, gas and other minerals, in, under and upon the following described lands⁷⁷

Following the granting clause was a “minimum royalty”⁷⁸ clause that the court referred to as a “royalty” clause:

Provided, that the grantors herein expressly covenant with the grantee that no oil and gas mining lease shall ever be executed covering the above land, or any part thereof, that shall reserve to the grantors herein, their heirs and assigns, as royalty, less than one-eighth of all of the oil and gas produced and saved from said land—and this covenant shall be deemed a covenant running with the land.⁷⁹

Following the “minimum royalty” clause was an “intention” clause which the court also treated as part of the “royalty” clause:

It is the intention of the parties hereto that the grantee herein, its successors or assigns, shall be entitled to receive hereunder *one-eighth of all oil and/or gas run to the credit of the royalty interest* reserved under and by virtue of any oil and gas mining lease now in force and effect . . . , and under any oil and gas mining lease hereafter executed⁸⁰

Additionally, after the royalty clause there was a “production” clause:

and in any event the grantee herein, its successors or assigns, shall be deemed the owner of and shall be entitled to receive one sixty-fourth of all oil and gas produced and saved from said land⁸¹

Thereafter, the plaintiffs, successors-in-interest to the grantors, and owners of the executive right, executed oil and gas leases that provided for overriding royalties of either $\frac{1}{8}$ th or $\frac{1}{16}$ th in addition to a $\frac{1}{8}$ th landowner’s royalty. After production was established on the land, division orders were prepared that provided for the owners of the non-participating royalty, the grantees, to share in the overriding royalty as well as the lease royalty.

77. *Barret*, 572 S.W.2d at 137.

78. The court referred to the clause as a “royalty” clause. *Id.*

79. *Id.*

80. *Id.* (emphasis added).

81. *Id.*

Litigation ensued to determine the proper division of the royalty and overriding royalties between the plaintiffs and defendants.

The Arkansas Supreme Court, affirming the decision of the chancellor, held that the nonparticipating royalty owners were only entitled to a $\frac{1}{64}$ th share of production which precluded their participation in the overriding royalty. The court reasoned that the granting clause, as further evidenced by the language of the “production clause,” conveyed only a $\frac{1}{64}$ th interest in the oil, gas and minerals produced. This interpretation clearly limited the claim of the nonparticipating royalty owners because if these royalty owners were to participate in the overriding royalty interest, they would receive more than a $\frac{1}{64}$ th interest. In effect, the court construed the deed as granting a *fractional royalty interest*.

The rationale for this result can be premised on the applicability of the rule of construction which provides that the granting clause, specifying the *fractional share*, controls over the inconsistent “royalty clause,” with its *fraction of royalty* language. In effect, the “repugnancy to the grant” rule of construction was applied. But the case can also be read as holding that the *fraction of language* in the “royalty clause” was only intended by the parties to permit the royalty owners to participate in the $\frac{1}{8}$ th lease royalty.⁸²

Anadarko Petroleum Co. v. Venable,⁸³ a 1993 Arkansas Supreme Court case, also involved the construction of nonparticipating royalty deeds containing conflicting *fractional share* and *fraction of royalty* clauses. Because the deeds are identical in form, differing only as to the fractional shares conveyed, the discussion will focus exclusively on one deed, the “Royal” deed.

The deed was executed in 1939 while the lands were subject to an existing oil and gas lease, the Tissue lease, that provided for a $\frac{1}{8}$ th royalty. The deed contained the following granting clause:

the grantee . . . shall at all times subsequent to the execution of this instrument, receive a ($\frac{1^3}{1920}$ ths) . . . part of all oil, gas and other minerals produced and saved from the above described land, . . . which provision and agreement is a covenant which shall run with the land⁸⁴

82. This reading of *Barret* is premised on the court’s articulation of the issue as to whether the “ $\frac{1}{8}$ th of royalty” language in the royalty clause permitted the royalty owners to share in “all royalty revenue” or the “usual $\frac{1}{8}$ th royalty.” *Id.* at 136.

83. 850 S.W.2d 302 (Ark. 1993).

84. *Anadarko*, 850 S.W.2d at 303.

The deed then contained the following subject to clause which the court described as a “second” granting clause:

It is understood that this land is encumbered with an oil and gas lease, executed by J.G. Tissue, a widower as Lessors, to Record Owners as Lessee, on — , which lease is recorded in Book — , at Page — ,

And for the same consideration the Grantors do hereby bargain, grant, sell, convey and set over onto the Grantee an undivided (13/240ths) . . . part of *all royalties* on oil or gas produced from the above described land during the term of said lease, or *any extension thereof*.⁸⁵

In the 1980’s, sometime after the expiration of the Tissue lease, the mineral owners executed oil and gas leases that provided for a $\frac{3}{16}$ th royalty.⁸⁶ The defendant, Anadarko Petroleum Co., the lessee, drilled producing wells on the leased lands. In 1983, the plaintiffs, the successors-in-interest of the grantees, executed division orders in favor of the defendant. The defendant was disbursing the proceeds from production and had calculated their royalty share as a straight $\frac{13}{1920}$ th share of production which was equivalent to payment on a $\frac{1}{8}$ th royalty basis.

In 1991, the plaintiffs sued the defendant in chancery court to establish their right to participate in the royalty on a $\frac{3}{16}$ th basis. The Arkansas Supreme Court, affirming the holding of the chancellor below, interpreted the 1939 deed as granting a *fraction of royalty* which permitted the plaintiffs to share in the royalty on a $\frac{3}{16}$ ths basis.

The court’s holding was premised on two bases. First, the portion of royalty granted, in the deed had to be determined by reading the “first” granting clause which granted a straight *fractional share* in conjunction with the “second” granting clause which granted a *fraction of royalty*. In so doing, the court rejected the defendant’s argument that the *fraction of royalty* contained in the second granting clause was merely “explanatory,” describing the scope of the *fractional share* conveyed in the first granting clause. The court reasoned that the language of the second granting clause

85. *Id.* (emphasis added).

86. The opinion alternatively describes the royalty share at issue as an overriding royalty and as a lease royalty share. For purposes of this discussion, I have assumed that the $\frac{3}{16}$ th share of royalty was a landowner’s royalty share.

“utilized all the terms of art of conveyance” and granted an “additional fractional one-eighth of” that was initially conveyed in the lease.⁸⁷

Additionally, the defendant argued that the language of the second granting clause, “during the term of said lease or *any extension thereof*,” indicated the parties did not contemplate that the clause would be applicable to “future leases.” The court rejected that argument and affirmed the chancellor’s finding that the subsequently executed oil and gas leases were an “extension” of the previously expired Tissue lease. Therefore, subject to the second granting clause, the grant of a *fraction of* royalty required payment of royalties on the $\frac{3}{16}$ th basis.

Despite the fact that the deed contained two granting clauses (the court emphasized and interpreted the second granting clause as intending to effectuate a conveyance), the case does not follow the “two grant” theory of *Luckel v. White*. In effect, by applying the “four corners” rule of construction, the court found that the parties to the conveyance intended the latter *fraction of* “royalty clause” to control over the former *fractional share* clause.

Moreover, the court held that the plaintiff’s execution of the division order, which calculated their royalty share on a $\frac{1}{8}$ th basis, did not preclude recovery from the defendant for the underpayment occasioned by the failure to pay royalty on the $\frac{3}{16}$ th basis. Although the court recognized the general rule that the purchaser of production may rely on the division order in making payment to the interest owners and not be liable in tort or contract for underpayment, the court refused to apply the rule for three reasons. First, the division order did not specifically indicate plaintiff’s ratification of the calculation of his ownership share or waiver of the right to challenge the calculation of his ownership share. Second, plaintiff’s lack of knowledge of the 1980 leases providing for the $\frac{3}{16}$ th royalty share prior to filing suit precluded applicability of the doctrine of estoppel and laches. Third, the record was devoid of any evidence regarding any payments made by Anadarko that interjected the rights of innocent third parties.⁸⁸

The court’s holding and rationale as to the failure of the division order to protect an operator paying royalty pursuant to its terms are difficult to

87. *Anadarko*, 850 S.W.2d at 306.

88. The court also held that the plaintiff’s action was not time-barred. Thus, the plaintiff was entitled to recover for the deficiency that accrued from the date of the execution of the division order in 1983. The statute of limitations applicable to division orders, Ark. Code Ann. § 16-56-111 (1987) which prescribes a five year limitations period for actions relating to written contracts, was tolled by the “partial payments,” i.e., the underpayment. *Anadarko*, 850 S.W.2d at 307.

determine from the language of the opinion. One would assume from the facts that Anadarko was making the excess royalty share payment, a $\frac{1}{16}$ th share, to the owners of the mineral estate who were burdened by the plaintiff's non-participating royalty interest. If so, pursuant to *Gavenda*, the operator was not unjustly enriched and should not have been liable for the period prior to plaintiff's revocation of the division order according to traditional theory.⁸⁹

*V. The Duty Of Care The Executive Right
Owes To The Non-Participating Royalty Owner*

The problem that peculiarly⁹⁰ haunts non-participating royalty interests to a *fraction of royalty*⁹¹ is that the owners do not participate in the leasing of the land which determines the quantum of lease royalty that they will receive from production. The owner of the executive right to the mineral estate negotiates and executes the oil and gas lease which fixes the amount of bonus, delay rentals and royalty to be paid under the lease. Thus, absent a judicial standard regulating the conduct owed by the owner of the executive right to the non-participating royalty owner, the latter would be at the mercy of the former as to the share of royalty received under the lease.

Typically, but not always,⁹² the owner of the mineral estate burdened by the non-participating royalty interest owns the executive right, as well as the right to the bonus and delay rental payments. Additionally, the mineral owner may also own the remaining share of royalty, if any, which has not been severed by prior non-participating royalty conveyances. An inherent conflict will exist between the mineral owner, who owns no interest or a partial interest in the royalty, and the non-participating royalty owner over the negotiation of the lease terms. The non-participating royalty owner will

89. See the discussion at *supra* notes 48–53.

90. For a discussion of the myriad instances in which the requisite standard of care that the executive rights owner owes to the non-executive interest holder is applicable, see 2 WILLIAMS & MEYERS, *supra* note 4, § 339.

91. The same problem exists to grants or reservations of “all of the royalty,” a phrase which encompasses all of the landowner's lease royalty. To facilitate the discussion as to the standard of care, the reference to the *fraction of royalty* includes the “all of the royalty” conveyancing phenomena.

92. A “naked” executive right, entitling the holder thereof to the development and leasing rights, may be severed in fee from the mineral estate without the executive rights holder owning any other interest in the mineral estate. The ownership of the non-executive interest is to a “non-participating mineral estate.” See RICHARD W. HEMINGWAY, *THE LAW OF OIL AND GAS* §§ 2.2 and 2.7(H) (West 3d ed. 1992).

want the maximum lease royalty. The mineral owner, however, has the incentive⁹³ to negotiate for a reduced lease royalty to maximize bonus⁹⁴ and delay rental payments. Likewise, looking for a future leasing opportunity and an additional bonus, the mineral owner may bargain for a lower royalty to obtain a shorter primary term. Finally, if the mineral owner also owns the surface, the lease royalty may be sacrificed for surface damage or non-development clauses.

The protection of the non-participating royalty owner lies in the standard of care imposed on the owner of the executive interest when negotiating lease benefits on behalf of the executive and non-executive interests.⁹⁵ The

93. Further complicating the applicability of the requisite standard of care, the executive holder may be motivated to negotiate for a reduced royalty share in an attempt to acquire a shorter primary term that may yield additional leasing opportunities with another bonus, surface damages, or non-development clauses. For a general discussion, see Ernest E. Smith, *Implications of a Fiduciary Standard of Conduct for the Holder of the Executive Right*, 64 TEX. L. REV. 371, 386–88 (1985) [hereinafter Smith III].

94. An additional complication is the fact that “bonus,” the consideration paid to the mineral owner for executing the oil and gas lease, need not be paid, as it typically is, in the form of a cash payment. Any consideration may be paid as bonus, including a share of production, such as an overriding royalty interest or a production payment. When the lease benefits include a share of production, in addition to the landowner’s royalty share, the issue presented is whether the share of production is “bonus” to be paid to the mineral owner or “royalty” to be paid to the royalty owner.

Two differing views exist in the case law. The Texas cases determine whether a share of production is bonus or royalty solely by whether the interest reserved has the generally accepted characteristics which define bonus or royalty. If the share of production is paid over the life of the lease, it is royalty. If it is a sum certain to be paid out of production, it is bonus. The parties’ express designation as to whether the interest is bonus or royalty is not controlling under Texas law. Thus, in *Griffith v. Taylor*, 291 S.W.2d 673, 675 (Tex. 1956), the reservation in an oil and gas lease of a $\frac{1}{16}$ th share of gross production to be paid over the life of the lease that expressly stated that it was “in addition to the royalties . . . , as additional consideration and bonus royalty” reserved a royalty interest. See also *Lane v. Elkins*, 441 S.W.2d 871 (Tex. Ct. App. 1969). Texas has consistently held that the typical overriding royalty reservation in an oil and gas lease is royalty that is to be paid to the royalty owner.

In Oklahoma, the parties’ designation in the lease as to whether the interest is bonus or royalty is determinative. Therefore, the intent, and not the characteristics of the interest reserved, is conclusive as to whether a production share granted in addition to royalty is bonus or royalty. The basis of the Oklahoma rule is *Sykes v. Dillingham*, 318 P.2d 416 (Okla. 1957), wherein the Oklahoma Supreme Court held that a share of production in excess of a $\frac{1}{8}$ th royalty intended by the parties to be a part of the consideration for the execution of the lease is bonus.

95. For a citation to the extensive literature on the duty that the executive owes the non-executive interest in negotiating the oil and gas lease, see Joshua M. Morse & Jaimie A.

evolution of that standard has not been uniform or without controversy.⁹⁶ The prevailing standards have been the traditional “utmost fair dealing” standard, sometimes referred to as the “prudent landowner” standard, and the “fiduciary” standard originating in the 1985 Texas case of *Manges v. Guerra*.⁹⁷

A. The Utmost Fair Dealing Standard

The “utmost fair dealing”⁹⁸ standard measures the duty the mineral owner owes to the non-participating royalty owner in executing the oil and gas lease. This standard is what a “reasonable prudent landowner,” owning the full mineral fee and not burdened by the outstanding non-participating royalty interest, would have done under the circumstances. The “utmost fair dealing” standard has traditionally been viewed as an intermediate standard between an unduly high fiduciary duty and an insufficiently low duty of good faith.⁹⁹ The “utmost fair dealing” standard is premised on an implied

Ross, *New Remedies for Executive Duty Breaches: The Courts Should Throw J.R. Ewing Out of the Oil Patch*, 40 ALA. L. REV. 187, 188 n.3 (1988).

96. For a discussion of the various labels used to describe the duty that the executive owner owes to the non-executive owner, see 2 WILLIAMS & MEYERS, *supra* note 4, § 339.2. Many of the descriptive terms, such as “utmost good faith,” have been used interchangeably to describe the traditionally prevalent “prudent landowner” standard of the “utmost fair dealing” duty. 2 WILLIAMS & MEYERS, *supra* note 4, § 339.2.

Differing opinions have been expressed over the years as to what standard of care could be imposed on the executive to adequately protect the non-executive interest. Suggestions have included the no duty rule; ordinary care and good faith standard; the utmost fair dealing standard; and the fiduciary duty. Lloyd Lochridge, *Abuse of Executive Rights*, 36th Oil & Gas Inst. § 2.02 (Matthew Bender 1985).

For a criticism of the “utmost fair dealing” duty, and its “prudent landowner” standard, see Morse and Ross, *supra* note 95, at 213–28.

97. 673 S.W.2d 180 (Tex. 1984).

98. The standard which requires the “same degree of diligence and discretion on the part of the mineral fee holder as would be expected of the average landowner . . .” was taken from a leading and oft quoted “utmost fair dealing” case, *Federal Land Bank v. United States*, 168 F. Supp. 788, 791 (Ct. Cl. 1958). In that case, the court held, *inter alia*, that the unreasonable delay in leasing by the mineral owner which delayed production until after a term royalty interest had expired violated the “utmost fair dealing” standard. The standard originates from an eminent law review article in the *Texas Law Review*, Jones, *Non-Participating Royalty*, 26 TEX. L. REV. 569, 574. For a short historical discussion of the evolution of the “utmost fair dealing” standard, see Morse & Ross, *supra* note 95, at 213–18.

99. Morse & Ross, *supra* note 95, at 9. See also Lochridge, *supra* note 96; 2 WILLIAMS & MEYERS, *supra* note 4, § 339.2, at 210.7.

covenant in the deed that severs the non-participating royalty interest from the mineral estate.¹⁰⁰

The standard implicitly recognizes that a mineral owner burdened by a *fraction of* non-participating royalty is entitled to pursue his self-interest when negotiating the bonus, delay rentals, and other advantageous lease terms. The mineral owner is not obliged to subordinate his interest to the interest of the non-participating royalty owner. However, the mineral owner cannot unduly benefit at the expense of the non-participating royalty owner when exercising the executive right.

The extent to which the mineral owner can act when pursuing his self-interest at the expense of the non-participating royalty owner is limited by the “prudent landowner” standard. If the reasonable prudent landowner, not burdened by the outstanding interest, would have negotiated the same deal that the mineral owner negotiated, the mineral owner will bear no liability. However, if the reasonable prudent landowner would have negotiated a deal more favorable to the royalty owner, the mineral owner may be liable.¹⁰¹

In sum, the “utmost fair dealing” standard examines the fairness of the lease royalty share to the non-participating royalty owner in relation to the other lease benefits obtained by the mineral owner. This standard is what an objective reasonable “prudent landowner” would have bargained for had he owned the full mineral fee.¹⁰²

The “utmost fair dealing” standard has been criticized for failing to provide adequate guidance and predictability in determining whether the mineral owner, in rejecting or accepting a lease proposal, will violate the standard. For example, assume that a mineral owner who owns no royalty is offered two lease proposals. The first is an offer to lease for a \$500 per acre bonus and a $\frac{1}{8}$ th royalty. The second lease offer is for a \$250 per acre bonus and a $\frac{3}{16}$ th royalty. The nearest production is one mile away and 30 years ago two dry holes were drilled on the tract. The well logs on the old dry holes are missing, if they ever existed. Seismic operations have been conducted in the area but the data is confidential to the proprietor and unavailable to the mineral owner. What’s an objective “prudent landowner” owning the full mineral fee to do? How does a lawyer advise the mineral

100. *Federal Land Bank v. United States*, 168 F. Supp. 788, 791 (Ct. Cl. 1958).

101. For the most common explication of the “prudent landowner” criteria of the “utmost good faith” standard, see 2 WILLIAMS & MEYERS, *supra* note 4, § 339.2.

102. Dean Ernest Smith notes, “As usually interpreted, utmost fair dealing requires the executive right holder to execute the same type of oil and gas lease on the same terms as he would have done in the absence of an outstanding non-participating interest in a third party.” Smith III, *supra* note 93, at 371–72.

owner who desires to make the right decision, i.e., take the \$500 per acre bonus, but who also wants to avoid the reasonable likelihood of litigation and, more importantly, the possibility of liability?

A commonly expressed view is that if the lease royalty negotiated by the executive is equal to the going royalty rate in the area, no violation of the “utmost fair dealing” standard will likely occur.¹⁰³ Conversely, a lease royalty of less than the going rate in the area portends a violation of the standard. Under these circumstances, the “utmost fair dealing” standard may reflect reality if all influences on lease terms in the area are equal. Leases may vary in regard to the primary term offered, the desirability and the availability of surface damage and non-development clauses or the proximity to drilling operations or production. Any change in the above facts may affect the royalty bargained for by an executive rights holder as to any particular tract. Thus, the royalty share negotiated by landowners in the area is not dispositive, nor necessarily relevant, to the royalty share for which the prudent landowner would have bargained. Perhaps, the more accurate statement of conventional wisdom is a lease royalty that is less than the going lease royalty rate should foreshadow litigation.

Another criticism of the prudent landowner standard is that it is inherently inconsistent. The standard permits the executive rights holder to pursue his self interest. However, in pursuing that self interest, he cannot benefit himself at the expense of the non-executive. Even though the apparent inconsistency may render the standard difficult to apply, the reason the standard emphasizes both the mineral owner’s self interest and protection of the non-executive is simple to explain. The mineral owner owns the right to the bonus, and like any other rational property owner, he should be free to secure the maximum return obtainable from his property. However, the mineral owner also negotiates the lease royalty share for the non-participating royalty owner. Thus, some limitation on the mineral owner’s right to pursue his self-interest to the detriment of the nonparticipating royalty owner when exercising the executive right is required. The “prudent landowner” standard or the “utmost fair dealing” standard attempts to balance the irreconcilable interests of the mineral owner and the non-participating royalty owner.

103. Dean Smith argues that the mineral owner should be free without liability under the prudent landowner standard to trade off a high bonus for a lower royalty, if the royalty is consistent with leasing practices in the area. Ernest E. Smith, *The Standard of Conduct Owed by Executive Right Holders and Operators to the Owners of Nonparticipating and Nonoperating Interests*, 32nd Oil & Gas Inst., at 241–44 (Matthew Bender 1981) [hereinafter Smith IV].

Finally, the standard is viewed by some as being insufficient to protect the interests of the non-executive owner from the rapacity, or lack of altruism, of the owner of the executive interest.¹⁰⁴ The executive owner controls the interests of the non-executive and determines their share in the lease benefits. Therefore, some conclude a more stringent standard of care than that reflected in the “utmost fair dealing” standard should be imposed on the executive, regardless of whatever proprietary interest the latter may also have in the mineral estate.

B. The Fiduciary Duty

In *Manges v. Guerra*,¹⁰⁵ the Texas Supreme Court held that the owner of the executive right to a non-participating mineral interest, who also owned a share of the mineral estate, owed a fiduciary duty¹⁰⁶ to the non-executive interests.

Manges, the executive, violated the fiduciary duty by leasing¹⁰⁷ in excess of 25,000 acres to himself for a ten year primary term, at a nominal bonus (\$5 inclusive), \$2 per acre annual delay rentals and a $\frac{1}{8}$ th royalty. Through the terms of the lease, Manges acquired the $\frac{7}{8}$ ths working interest.¹⁰⁸

104. Morse & Ross, *supra* note 95, at 229–30.

105. 673 S.W.2d 180 (Tex. 1984).

106. It is disputed as to whether *Manges* applied a “fiduciary duty” or the traditional “utmost fair dealing” standard. The argument for the former is based in part on an initial opinion issued in the case but subsequently withdrawn by the Texas Supreme Court, *Manges v. Guerra*, 26 Tex. Sup. Ct. 430 (June 8, 1983) (opinion withdrawn). This initial opinion contained no language indicating that a fiduciary duty was imposed. However, the substituted opinion, *Manges v. Guerra*, 673 S.W.2d 180 (Tex. 1984), contained such language. For an analysis of the case that favors the fiduciary duty construction, see Smith III, *supra* note 93, at 377–78.

107. Manges also acquired other benefits for himself which were not shared with his non-executive mineral cotenants. First, Manges mortgaged by deed of trust the executive right to secure a promissory note for approximately \$7 million. Next, in connection with another loan of \$2.8 million (later increased to \$5 million), Manges granted an option to purchase the production from the mineral estate to a third-party. In addition to securing the loans which benefitted Manges but not his nonexecutive mineral cotenants, both transactions removed the mineral estate from the leasing market. *Manges*, 673 S.W.2d at 182.

The mortgagee declared at trial that the mortgage was not effective as to the mineral interests. The trial court declared the mortgage to be ineffective and nonexistent as to the executive interest. In addition, the trial court canceled the option to purchase production and found Manges liable for failing to lease other lands not subject to the Manges to Manges lease, which he could have leased to a third party but did not. *Id.* at 183.

108. When Manges executed the lease to himself, the land was being drained by offset production and the non-participating mineral owners had filed suit with *lis pendens*. Manges argued that the suit with *lis pendens* precluded him from leasing to others. *Id.* at 182. In

Shortly thereafter, Manges farmed-out the lease to a third-party, retaining 50% of the working interest cost-free.

The *Manges* court recognized that the fiduciary duty existing between the executive and non-executive is specifically based on the relationship of the parties, not on a covenant implied in the deed. The *Manges* court determined that the fiduciary duty required the executive to acquire for the non-executive every benefit that the executive acquired for himself. Manges, through his self-dealing, gained “special benefits.” The $\frac{7}{8}$ ths working interest from the Manges to Manges lease and the $\frac{1}{2}$ cost-free working interest from the farm-out were not shared with his non-executives. Therefore, in addition to actual damages, the court determined that the non-participating mineral owners also were entitled to cancellation of the Manges to Manges lease and exemplary damages.¹⁰⁹ However, the court determined that the non-participating mineral owners’ election to sue for damages precluded the remedy of cancellation of Manges’ executive right.¹¹⁰

The extent to which the holding in *Manges* elevates the standard of care owed by the executive to the non-executive in the management of the mineral estate remains unclear. Typically, a fiduciary duty implies a more stringent standard than exists under the “utmost fair dealing” standard. The fiduciary standard implicitly suggests that the executive’s right to pursue his own self-interest is limited or proscribed.

However, the fiduciary duty in *Manges* was imposed under circumstances in which a cotenancy between the executive and non-executive interests existed in the mineral estate. Manges owned an undivided $\frac{1}{2}$ mineral estate and the executive right to the $\frac{1}{2}$ non-participating mineral estate. The fiduciary duty required the executive to acquire for the non-executive every benefit that he exacted for himself. By procuring benefits that profit only the executive interest, the executive

addition to the farm-out, discussed in the text of this article, Manges also granted a “top lease” to the third-party that was to be effective if the Manges to Manges lease was judicially canceled. *Id.* at 183.

109. The non-participating mineral owners recovered the following from Manges for his breach of the fiduciary obligation: their proportionate share as cotenants of the net profits from the wells drilled on the canceled Manges-Manges lease; actual damages of \$382,608.79; and exemplary damages of \$500,000. *Id.* at 183, 184–85.

110. The non-participating mineral owner’s basis for canceling the executive right in Manges was “fraudulent inducement” to convey the executive right to Manges in the deed of severance. The trial court found that the non-participating mineral owners had been fraudulently induced to convey their executive interests. *Id.* at 184.

incurs liability. Concomitantly, the pursuit of self-interest by the executive at the expense of the non-executive is actionable.

A fiduciary duty requiring participation on a proportionate ownership basis in all of the lease benefits is appropriate when the executive and non-executive interests share a cotenancy relationship in the mineral estate. When a cotenancy exists, there is no necessity to recognize or protect the pursuit of self-interest that results in a division of lease benefits unrelated to the proportional ownership interests.

When a mineral owner burdened by a *fraction of nonparticipating royalty* interest exercises the executive right, both parties do not share on a proportional ownership basis. The relationship is unlike the cotenancy relationship in *Manges*. The mineral owner is entitled to the bonus, delay rental payments, and only a partial share, if any, of the lease royalty. The non-participating royalty owner participates only in his share of lease royalty. Thus, the mandate of the fiduciary duty in *Manges*, the acquisition of identical benefits for the non-executive when the executive negotiates the lease, cannot be applied when the non-executive is a non-participating royalty owner.

That does not mean, however, that the *Manges* decision has not raised the standard of care that the mineral owner owes to the non-participating royalty owner. There has been speculation about the exact standard the fiduciary duty imposes on the mineral owner who exercises the executive right in regard to the non-participating royalty interest. One view is that the fiduciary duty prohibits the executive from “acting against the non-executive’s interest” and requires the executive to “act affirmatively to protect the non-executive’s interest.”¹¹¹ Another view is that the executive’s role is analogous to the role of a “trustee” who is also the “life beneficiary” of the trust, “who can take his own interest into account in making decisions when administering the trust . . . but cannot take unfair advantage . . . by making decisions that . . . substantially disadvantage or effectively destroy the remainder interest.”¹¹² Under the latter view, the executive would be entitled to take his own interest into account and consider the right to bonus and delay rentals, so long as his decisions were in good faith and did not substantially disadvantage the royalty owner.¹¹³

111. Morse & Ross, *supra* note 95, at 232.

112. Smith III, *supra* note 93, at 387–88.

113. Smith III, *supra* note 93, at 387–88. Smith also suggests that the executive under this standard should be able to trade a large royalty ($\frac{1}{6}$ th) and a small bonus for a large bonus and small royalty ($\frac{1}{8}$ th) so long as the small royalty is consistent with current leasing practices in the area.

Hopefully, if the *Manges* decision elevated the standard of care that the mineral owner owes when exercising the executive right in regard to the *fraction of* non-participating royalty interests, the new standard will not unduly limit or proscribe the mineral owner's self-interest when negotiating the lease bonus, delay rentals, and other lease benefits like surface damages. Requiring the mineral owner to subordinate his interest in a reasonable bonus or surface damage protection will diminish his property interest and violate the intent of the parties to the deed of severance.¹¹⁴

Despite the uncertainty that lingers as to the *Manges* decision's effect on the standard of care, no one doubts that the case has obviously expanded the remedies available to the non-executive, including the non-participating royalty owner. The remedies are now premised on a breach of the fiduciary duty, as opposed to a breach of the implied contract of the "utmost fair dealing" standard. Remedies familiar under the law of fiduciaries such as exemplary damages, cancellation of either the lease, the executive right, or both; and the imposition of a resulting or constructive trust are now potentially recoverable by the nonexecutive.¹¹⁵

However, the Texas Civil Appellate Courts have not construed the *Manges* decision as dictating a wholesale abandoning of the "utmost fair dealing" standard with its prudent landowner test. Emphasizing that *Manges* involved cotenants to a mineral interest where the executive owner had determined by lease the share of royalty, bonus, and delay rentals received by the non-participating mineral owners, the appellate courts have limited the fiduciary duty imposed by *Manges* to instances in which the executive "controls" the amount of lease benefits received by a non-executive owner.¹¹⁶ Thus, the fiduciary duty of *Manges* is imposed on a

114. Mack Keith McCollum, *Manges v. Guerra: The Executive Right Holder Undergoes Close Scrutiny*, 38 BAYLOR L. REV. 189, 203 (1986).

115. For a complete description of the potential remedies, see Morse & Ross, *supra* note 95, at 231.

116. The distinction that "control" over the lease benefits is determinative as to whether the fiduciary standard of *Manges* is applicable appears well-entrenched in the Texas Civil Appellate Courts. For example, in *Dearing, Inc. v. Spiller*, 824 S.W.2d 728 (Tex. Ct. App. 1992), the fiduciary standard was applied to a non-participating mineral interest. *Mims v. Beall*, 810 S.W.2d 876 (Tex. Ct. App. 1991), involved the applicability of the fiduciary standard to a *fraction of* non-participating royalty interest. *Pickens v. Hope*, 764 S.W.2d 256, 263-64 (Tex. Ct. App. 1988), rejected the applicability of the fiduciary duty to a *fractional share* royalty interest and applied the "utmost good faith" prudent landowner standard. Finally, *Comanche Land & Cattle Co. v. Adams*, 688 S.W.2d 914 (Tex. Ct. App. 1985), applied the fiduciary duty standard to a *fraction of* defeasible term non-participating royalty interest.

mineral owner with the executive right to a *fraction of* non-participating royalty.¹¹⁷ The imposition of this duty mandates, at least,¹¹⁸ that the owner of the latter interest receive their proportionate share of whatever royalty the executive obtains in the lease negotiation. Conversely, the *fractional share* royalty interest which is entitled to its fixed fractional share regardless of the size of the lease royalty, is protected by the “utmost fair dealing” standard of the prudent landowner test.¹¹⁹

*Mims v. Beal*¹²⁰ is an illustrative case. In that case, the plaintiffs owned a $\frac{1}{4}$ th of non-participating royalties with John Mims and his wife, Chattie, owning the executive right. The Mimses executed an oil and gas lease to their son, Angus Mims, that provided for no bonus and a $\frac{1}{8}$ th royalty. Five months later, Angus Mims assigned the lease to a third-party in return for a $\frac{1}{16}$ th overriding royalty. Plaintiffs, contending that the $\frac{1}{8}$ th royalty in the Angus Mims lease was unreasonably low, sued John and Chattie Mims and Angus Mims for damages occasioned by breach of the duty owed by the executive to the non-executive in the Mims to Mims lease. Finding that the “duty of good faith and fair dealing” was breached, the trial court awarded actual damages against the Mimses. Also, for “participating in the breach,” the court assessed actual damages against Angus Mims. A constructive trust was imposed on the nonparticipating royalty owner’s share of the overriding interest in the third-party lease. Further, finding that both parties acted in an “unconscionable, willful, and wanton manner and in total disregard of the plaintiffs’ rights,” exemplary damages of \$2500 were assessed against the Mimses and \$5000 against Angus Mims.

On appeal, both defendants argued that no fiduciary relationship existed between the Mimses and the plaintiffs. The court rejected the defendants’ argument and held that the fiduciary standard of *Manges* applied because the exercise of the executive right “controlled” the amount of royalty that the *fraction of* non-participating royalty interest receives under the lease. The executive violated the fiduciary obligation in several respects by executing the Mims to Mims lease. For example, the executive engaged in “self dealing” which included parents dealing with a son and a failure to negotiate at arms length for current market terms. Moreover, as a consequence of the self-dealing, the son’s overriding royalty interest reserved in the third-party lease was treated as if it were owned by the

117. See *Mims*, 810 S.W.2d at 876; *Comanche Land and Cattle Co.*, 688 S.W.2d at 914.

118. The question remains unanswered as to whether the fiduciary standard of *Manges* requires the executive to exact for the non-executive the highest royalty obtainable.

119. *Pickens*, 764 S.W.2d at 263.

120. 810 S.W.2d 876 (Tex. Ct. App. 1991).

parents. This resulted in the executives having exacted a royalty share for themselves which was not shared with the non-participating royalty owner. Therefore, on appeal, the court affirmed the award of actual and exemplary damages against the executives, the Mimses, as well as the imposition of the constructive trust on the overriding interest.

VI. The Lessee's Liability For Inducing Or Participating In The Breach Of The Standard Of Care

Mims v. Beall illustrates the potential for a lessee to incur liability in the leasing transaction in which the mineral owner with the executive right violates the requisite standard of care owed to the non-executive interest. Angus Mims, the son, was the lessee to the lease in which the executives, his parents, violated the fiduciary duty to the nonparticipating royalty owners. As the lessee, Angus Mims did not owe a fiduciary duty to the non-participating royalty owners. However, the court determined that as the lessee, Angus Mims was liable to the non-executive interest for “knowingly participating” in the breach of the executive duty. Thus, the court affirmed the award of actual and exemplary damages against the lessee. Further, the court determined that an executive who breaches the standard of care owed to the non-executive and the lessee who induces or participates in that breach are jointly and severally liable.

The general rule of liability for the lessee who takes a lease from an executive subject to a non-executive interest was stated in *Mims v. Beall*:

So long as the lessee maintains an arm's length position in the transaction, he does not owe a fiduciary duty or a duty of utmost good faith to the owner of the non-executive interest. If, however, the lessee agrees with the executive to an arrangement made for the purpose of excluding or minimizing the benefits of an outstanding or non-participating interest owner, the lessee can be held liable to the injured third party.¹²¹

Thus, if the lessee either “induces” the executive to breach the standard of care or “knowingly participates” in the breach, for example, by agreeing to an arrangement with the executive for the express purpose of lessening the non-executive's lease benefits, the lessee is liable to the non-executive interest. “Induce” clearly encompasses “planting the seed in the mind” of the executive that the two should cut a deal that breaches the duty. However, the mere offer of a lower than prevailing royalty and a higher than customary bonus by the lessee as a special incentive for the executive

to grant the lease may well constitute “inducement” and cause the lessee to incur liability. Furthermore, the lessee also cannot “knowingly participate” in the executive’s perpetration of the breach of duty owed to the non-executive. The lessee cannot agree with the executive to a royalty share that has the express purpose of excluding or lessening the non-participating royalty owner’s royalty share.

More importantly, the court indicated that the lessee may also be liable if he should reasonably have been aware that the executive was acting in breach of his duty. As to this basis of liability, the court further noted that the fact that the non-participating royalty deed is recorded puts the lessee on constructive notice of the existence of the nonparticipating royalty owner.

An important lesson of *Mims v. Beall* is that the lessee can avoid liability while negotiating a lease from a mineral owner burdened by a non-participating royalty interest. A fundamental premise of the decision is that the lessee does not owe a fiduciary duty or a duty of utmost fair dealing to the non-participating royalty owner. So long as the lessee maintains the negotiations with the executive owner at arms length and secures a lease from the executive that is competitive with current market conditions, including the royalty prevailing in the area, the lessee should be able to avoid liability.

However, what is unsettling about *Mims v. Beall* is the court’s dicta that indicates the lessee may be liable if he should have reasonably been aware that the executive was acting in breach of the executive’s duty to the non-participating royalty owner. Thus, if a lease is taken on the basis of a superficial title search which does not determine the existence and extent of non-participating royalty interests but only focuses on the ownership of the executive right, the lessee may be found liable to the non-participating royalty owner for agreeing to lease terms that involve unusually low royalty or an overriding royalty interest that is structured as bonus.

VII. Conclusion

Non-participating royalty interests should incite caution in both the lawyer and the landman. There is an important difference between a *fraction of* and a *fractional share* royalty interest. Care must be taken when construing royalty deeds to determine if a *fraction of* or a *fractional share* royalty has been conveyed. Older royalty conveyances have created a wealth of interpretation problems and an array of inconsistent, often puzzling case law. Finally, courts are construing more stringently the substantive content of the duty that a mineral owner owes to the *fraction of*

non-participating royalty owner when negotiating the oil and gas lease and are awarding more drastic remedies for breach of this duty. Even though the lessee owes no duty to the non-participating royalty owner in the lease negotiations, to avoid the imposition of liability including the possibility of punitive damages and lease cancellation, the lessee must exercise care to avoid “inducing” or “knowingly participating” in the executive’s breach, or being caught in a situation where the lessee “should have known that he was participating” in the executive’s breach.