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When the owner of the mineral estate separately transfers one or more incidents of his mineral ownership, difficulties and specialized oil and gas legal problems arise. Directing his discussion toward both the local practitioner in his dealing with oil and gas titles and the student in preparing for future practice, the author analyzes the troublesome concepts of fee royalty and mineral interests.

## FEE ROYALTY CONVEYANCING IN WYOMING

*John D. Lawyer\**

THE landowners' fee royalty interest as distinguished from a mineral interest has been an endless source of confusion, discussion and litigation in all oil-producing states. Unfortunately the term "royalty" has a generalized, indefinite meaning approximating "mineral interest" and is frequently so used by the oil fraternity, landowners, and speculators; alternately the term "royalty" has a highly esoteric definition utilized by different members of the same group. The parties who utilize the term "royalty" in their agreements frequently do not bother to tell us which if any definition of "royalty" they have in mind. Many parties deal in royalty interests and are not even aware of these alternate definitions.

Real property law is concerned with rights in land. It is the genius of Anglo-American real property law that individual parties are permitted to freely divide these rights amongst themselves in just about any manner they may choose. It is the adding and taking away, or passing or withholding of each separate right between the parties involved which gives rise to the various concepts and definitions of interests in real property. However, the inadvertent addition of certain

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rights not customarily associated with a royalty interest presents a serious construction problem. Additionally, the failure to recognize the double fraction problem, not only complicates interpretation but can result in an eightfold dilution of interest.

If A, the owner in fee simple of Blackacre, conveys all rights in minerals to B, we find that A remains the owner in fee simple of the surface estate in Blackacre, while B is the owner in fee simple of the mineral estate.<sup>1</sup> This presents the first concept of mineral law as a special branch of real property law—simply that there may be an estate in the minerals separate and distinct from the estate in the surface. As such it is referred to as the “severed mineral estate,” but it is real property in the same sense that the surface constitutes real property, and as an estate in real property it is subject to the same rules of law applicable to the surface interests. The severed mineral estate in itself presents no unusual or even specialized problems.

The mineral estate is customarily defined with respect to the rights which are incident thereto. The owner, having the right of ingress and egress, may, but practically never does, drill his own well and produce his own oil. In addition to drilling he also has the right to execute an oil and gas lease, thus assigning the drilling right to another. This right to execute an oil and gas lease is referred to technically as the “executory right.” The right of ingress and egress in the mineral owner exists for the purpose of exploration and development. The executory right is but the other side of the same coin and serves to vest in the oil and gas lessee the lessor’s exploration and development rights.

As consideration for the execution of the oil and gas lease the mineral owner receives an initial payment termed “bonus,” and thereafter, if the lessee desires to keep the

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1. The severed mineral estate is well established in Wyoming. *Ohio Oil Co. v. Wyoming Agency*, 63 Wyo. 187, 179 P.2d 773 (1947), noted in 2 Wyo. L.J. 62 (1948). Whether a severance of all minerals without specific mention of oil and gas includes oil and gas has not been specifically ruled on in Wyoming. *Kuntz, Law Relating to Oil and Gas in Wyoming*, 3 Wyo. L.J. 107, 108, 116 (1949). However, in *Picard v. Richards*, 366 P.2d 119 (Wyo. 1961) the reservation was of “a non-participating 20% royalty interest in and to the above-described lands” and the court assumed without discussion that this was a reserved interest in oil and gas.

lease in effect during the primary term he pays the mineral owner "delay rentals." In the event of production, it is the mineral owner who receives the "royalty" stipulated in the lease, which customarily is one-eighth of the gross production free of operating costs. If B owns the entire mineral estate he will receive payment as royalty for one of each eight barrels produced, but if he owns an undivided one-half of the mineral estate he will normally be entitled under the lease to receive payment for one-half of each eight barrels produced (one-sixteenth). Thus the mineral owner receives as a royalty payment under a typical lease his mineral ownership fraction of the total one-eighth royalty. The surface owner receives nothing from production unless he also happens to own a mineral interest.

It is when the owner of the minerals separately transfers one or more, but not all, of these incidents of mineral ownership that difficulties and specialized oil and gas legal problems begin to be encountered. If B, owning all of the mineral estate, transfers to C all of his right of ingress and egress, his executory right to lease, his right to receive bonus, his right to receive delay rentals, and his right to receive royalty, except that B reserves the right to receive one-half of the one-eighth royalty, we find that C becomes the owner of the mineral estate in fee simple but that B remains the owner of a one-sixteenth royalty in fee. If C should drill the well himself, he would be obliged to pay the one-sixteenth royalty to B, *i.e.*, to pay to B the value of one-sixteenth of the gross production. If, instead, C executes an oil and gas lease, C is entitled to receive all of the bonus as well as all delay rentals. B executes nothing but simply waits for production. In the event production results, C instead of receiving the total one-eighth royalty under the lease, will receive one-eighth less than the one-sixteenth, which is paid to B. From this approach as to the rights of each party it becomes apparent that B's fee royalty interest is derived from or carved out of the fee mineral interest. The fee royalty interest, hence, is less than a fee mineral interest.

This is the esoteric royalty interest, which has been defined as follows:

Non-participating royalty has a well-understood meaning in the oil industry. It may be defined as an interest in the gross production of oil, gas, and other minerals carved out of the mineral fee estate as a fee royalty, which does not carry with it the right to participate in the execution of, the bonus payable for, or the delay rentals to accrue under, oil, gas, and mineral leases executed by the owner of the mineral fee estate. The exclusive-leasing privilege remaining in the mineral fee owner is commonly referred to and known as the "executive right."<sup>2</sup>

And the distinction between royalty and mineral has been described in this manner:

[A]n interest in royalty is an interest in the proceeds derived from the minerals which a lessee has located, developed and produced, while an interest in the minerals is an interest in those natural resources before recovery, necessitating their location, development and production before being reduced to actual possession.<sup>3</sup>

In its positive or active attributes, royalty is an interest in the gross production. The term "non-participating" on the other hand emphasizes the negative or passive aspect of a fee royalty interest. These aspects are negative or passive in that the royalty owner does not participate in making the lease, sharing the bonus, or sharing the delay rentals. But on the active or positive side the royalty owner does participate in receiving payment for production—but that is all.

The few Wyoming cases dealing squarely with the landowners' royalty, both in *ratio decidendi* and rather prolific dicta, reveal classical treatment.

In *Denver Joint Stock Land Bank v. Dixon*<sup>4</sup> it was held that a surface owner with a retained fractional royalty interest passes his royalty along with the surface interest when he executes a mortgage of his real property without specific reference to the royalty. The royalty, being an interest in realty, passed to the purchaser at the mortgage

2. Jones, *Non-Participating Royalty*, 26 TEXAS L. REV. 569 (1948). To the same effect see *Picard v. Richards*, 366 P.2d 119, 122-23 (Wyo. 1961).

3. *Surety Royalty Co. v. Sullivan*, 275 P.2d 259, 263 (Okla. 1954), quoted in Maxwell, *A Primer of Mineral and Royalty Conveyancing*, 3 U.C.L.A. L. REV. 449, 453 (1956).

4. 57 Wyo. 523, 122 P.2d 842 (1942).

foreclosure sale. All cases construing a landowner's or non-participating royalty in Wyoming have involved royalty interests which at the time of their creation were not burdened by or subject to an oil and gas lease or, if possibly under lease, such leases clearly terminated subsequently without production. Thus the adjudicated cases do not require that there be either an existing lease or production at the time the royalty interest is created, and the existence of a lease, or production at the time of creation, is immaterial to the validity of the landowners' fee royalty.

In *McGinnis v. McGinnis*<sup>5</sup> an assignment to a trustee of all royalty by various landowners with respect to their individual tracts was held valid, so that the landowner who had executed the assignment was required to account for and pay over to the trustee all royalties he had received from subsequent production obtained on his separate tract. The trust had been executed for the benefit of the various landowners who had executed the royalty assignment so that their royalty in their individual tracts might be pooled and shared; the trust was sustained as not violative of the rules against perpetuities as rights in the royalties were held to have vested, even though there was no provision for the eventual termination of the trust. In *Picard v. Richards*<sup>6</sup> the court was called upon to construe that which the parties had stipulated to be a "non-participating undivided 1/5 part of the mineral estate." It was held that this hybrid interest which had been stripped of all rights other than to receive royalty was therefore a 1/40 non-participating royalty.

From these cases it is clear that in Wyoming a royalty interest in fee is a real property interest fully vested at the time of execution, whether or not there is a lease in existence<sup>7</sup>

5. 391 P.2d 927 (Wyo. 1964), noted in 19 Wyo. L.J. 248 (1965).

6. 366 P.2d 119 (Wyo. 1961).

7. Thus the problem is escaped in Kansas where a permanent non-participating royalty in future leases is not recognized. *Bellport v. Harrison*, 123 Kan. 310, 255 Pac. 52 (1927). Unfortunately *Bellport* was cited in *Simson v. Langholz*, 133 Colo. 203, 293 P.2d 302 (1956) and thereby clouds the validity of perpetual non-participating royalties in Colorado. Montana formerly regarded the presence or absence of an existing lease at the time of execution of the "royalty" or mineral conveyance as significant, and construed a "royalty" interest as a mineral interest if there were no existing lease. *Marias River Syndicate v. Big West Oil Co.*, 98 Mont. 254, 38 P.2d 599 (1934). However, the mere existence or absence of an existing lease is no longer of significance. *Rist v. Toole County*, 117 Mont. 426, 159 P.2d 340 (1945); *Stokes v. Tutvet*, 134 Mont. 250, 328 P.2d 1096 (1958).

or actual production and regardless of the name attached to the instrument creating the interest. The rights created by the parties, not the name, nor an occasional inadvertent or malapros phrase, establishes what it is.<sup>8</sup>

This dual approach to the definition of a non-participating royalty in both its positive and negative aspects also lends itself to dual or alternate methods of conveyancing. What might be termed the positive form of conveyance is the type of royalty deed which conveys to the grantee: "an undivided ..... royalty of all the oil and all of the gas produced and saved . . . ." On the other hand there are many printed royalty forms in use in Wyoming whereby the granting clause reads: "an undivided ..... interest in and to all the oil and gas and other minerals in, under, and upon . . . ." This latter language is identical to that contained in a mineral deed! However, the form then proceeds to provide that the grantor reserves the rights of ingress and egress, to lease, and to receive all bonuses and delay rentals.

In theory there is nothing wrong in this latter method of granting first a full mineral interest and then stripping down that grant and either by reservation or definition stating that the grantee receives no rights of ingress and egress, leasing, bonus or delay rentals. This type of deed which first grants a full mineral interest and then emphasizes the negative by reserving from the mineral grant all of the aspects which are not of a royalty nature is in prevalent use in Wyoming.

One of the printed forms sometimes encountered in Wyoming is entitled "Non-Participating Royalty Conveyance" and is of the latter type except that it grants to the royalty owner rather than reserving to the mineral owner the right of ingress and egress. Some danger can be anticipated if the right of ingress and egress (particularly when it is realized that the right of ingress and egress contains or implies the right to lease), is added to the grant. A royalty owner needs no right of ingress and egress, and the coupling of a right of ingress and egress to a royalty interest is worse than a useless fifth wheel; it is an open invitation to disaster.

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8. *Picard v. Richards*, 366 P.2d 119, 123 (Wyo. 1961).

Indeed the Oklahoma case of *Pease v. Dolzeal*<sup>9</sup> gives fair warning of what happens when the right of ingress and egress is tacked to what might otherwise be a royalty. The reservation contained in the deed construed in *Pease* reads as follows:

Said party of the first part (W. L. Pease), his heirs and assigns, hereby reserves 1/16 of all oil and gas produced from the above described land and, also reserves the right of ingress and egress from said property for the purpose of drilling for oil and gas.

The land was not subject to an oil and gas lease at the time of the conveyance. While there were other factors involved, the Oklahoma court stated:

In view of the fact that the grantor expressly retained the right of ingress and egress and the right to lease his interest in the land for oil and gas, as evidenced by the language used in his conveyances of interest therein, we conclude that he reserved only an interest in the mineral rights and not a net interest in the royalty.<sup>10</sup>

The net consequence to the owner of the reserved interest was that what might have been a 1/16 royalty interest was, by virtue of his also holding the right of ingress and egress, converted to a 1/16 mineral interest. As a mineral interest owner he was not entitled to 1/16 of gross production but 1/16 of 1/8, or only 1/128 of gross production. The fact that he was also entitled to participate in 1/16 of rents and bonuses was probably small consolation.

Similarly, the simple addition of the word "rights" to otherwise royalty language adds to the danger that royalty will be construed as a mineral interest. In the Oklahoma case of *Cook v. McClellan*,<sup>11</sup> cited favorably by the Wyoming court in *Picard v. Richards*,<sup>12</sup> the reservation simply provided that "first party reserves . . . an equal one-sixteenth royalty interest in all Oil, Gas, or Mineral *rights*." (Emphasis added.)

The Oklahoma court, emphasizing the word "rights," construed this reservation as a mineral interest.

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9. 206 Okla. 696, 246 P.2d 757 (1952).

10. *Id.* at 699, 246 P.2d at 761.

11. 311 P.2d 244 (Okla. 1957).

12. 366 P.2d 119, 121 (Wyo. 1961).



The Wyoming Supreme Court has not been confronted with such a situation, but when terms are missused and ambiguity is patent on the face there is no reason why a court should not apply the general broad definition of royalty rather than the esoteric definition, if such would better carry out the apparent intention of the parties.<sup>13</sup>

The double fraction problem is the source of much confusion in royalty conveyancing. While, as indicated above, a mineral owner receives his fractional mineral interest of the reserved royalty (which is customarily one-eighth), the fractional designation utilized in a royalty deed is usually more confusing because the word royalty as a general term is vague, and further complicated by the fact that frequently it is not known whether the parties are speaking of royalty as a fraction of the whole of production (eight-eighths) or a fraction of the one-eighth royalty interest. If a party owns the entire mineral interest and desires to convey whatever would be one-half of what he would receive as a royalty, he might conceivably, rightly or wrongly, choose any of the following expressions: a 1/16 royalty, 1/2 of the 1/8 royalty interest, a 1/2 royalty interest, 1/2 of the royalty, and yet none of the above expressions standing alone are free of ambiguity, and conceivably one or more of the expressions could be construed as meaning 1/2, 1/16, or 1/128 of the total production. The ambiguity exists because of the implied fraction 1/8. If there is a current oil and gas lease in existence, the parties may be thinking of one-half of the current existing royalty, but since they are creating a perpetual royalty interest they may also recognize that one-half of the existing royalty will be the same as a one-sixteenth royalty after the termination of the existing lease. Unfortunately, it appears that "1/2 of the royalty" is equal to "a 1/16 royalty," and there is little grammatical justification for the apparent difference

13. The Montana Supreme Court frankly recognizes that it does just that:

This court, however, has repeatedly and consistently given strict interpretation to the qualifying words with which the word "royalty" appears. Although Montana has consistently stated rather pontifically, that the word "royalty" has a strict meaning, nevertheless we have just as consistently ignored the word when it is used in conjunction with others, and looked to its associates to construe its meaning. So long as Montana adheres to this principle we do not feel impelled to give the word "royalty" any more strict construction than it has been given in the past.

Stokes v. Tutvet, *supra* note 7, 328 P.2d at 1103.

or similarity. There is no single phrase which, used alone, will guarantee uniform construction. It is the context within which the phrase is used, as well as the circumstances under which the instrument is executed, which will control, or at least guide a court in a confusing situation.<sup>14</sup>

Sometimes one suspects that the fraction itself guides the court to a construction. Thus, while a one-sixteenth royalty interest usually appears reasonable, a one-third royalty is more likely to be construed as  $1/3$  of the  $1/8$  royalty ( $1/24$ ). Of course the parties could conceivably desire to create a true one-third royalty interest, *i.e.*, the right to receive one out of every three barrels produced free of cost. But a large royalty would constitute such a burden as to probably frustrate the possibility of leasing or exploration and development by even the mineral fee owner. Therefore a court is almost forced to construe a large fractional interest (*i.e.*, any fraction over one-eighth) as either a mineral interest<sup>15</sup> or a fraction of the customary one-eighth royalty interest.<sup>16</sup> Although this policy need not exist when the fraction expressed in the conveyance is less than one-eighth, it does not follow that a court will inevitably construe "1/16 royalty interest" as meaning one out of sixteen barrels. It might construe the term as being  $1/16$  of the  $1/8$ , thus resulting in only a  $1/128$  interest.<sup>17</sup>

If the form of the conveyance and the transaction itself is free of ambiguity, then a royalty deed of the first or positive type described above would call for the fraction to be expressed as the fraction of the total production. Thus a

14. Other aspects of the double fraction problem are discussed in Masterson, *Double Fractions Problems in Instruments Involving Mineral Interests*, 11 Sw. L.J. 281 (1957).

15. *E.g.*, the Colorado Supreme Court, in *Simson v. Langholf*, 133 Colo. 208, 293 P.2d 302 (1956), construed a grant of "forty-nine per cent (49%) of all oil and/or gas that may be produced and saved and marketed . . ." as a mineral interest instead of a royalty interest, thus entitling the grantee to 49% of  $1/8$ th instead of 49% of all production.

16. In *Picard v. Richards*, *supra* note 1, the court construed a "non-participating  $1/5$ th mineral interest" to be a non-participating royalty interest not entitled to participate in bonus or delay rental. However, it was also held that the royalty owner was entitled to one-fifth of one-eighth, or one-fortieth of total production and not twenty per cent of gross production.

17. In *Cook v. McClellan*, 311 P.2d 244 (Okla. 1957), the reservation was of "an equal one-sixteenth royalty interest in all Oil, Gas, or Mineral rights." The word rights converted the royalty interest to a mineral interest with a consequent eightfold dilution.

grantor might convey a one-sixteenth royalty of all the oil and all of the gas produced and saved. Generally, however, in using the second type or negative form of deed the fraction is expressed as a fraction of the mineral interest or a fraction of the one-eighth royalty. It becomes necessary, if the desire is to convey the same one-sixteenth royalty referred to above, that this second form of conveyance call for one-half of the mineral interest or one-half of the royalty interest. In utilizing printed forms it becomes obvious that extreme care must be taken in determining the proper fraction to be specified in the royalty instrument.

A further source of minor confusion in Wyoming has been the frequent utilization of the broker's term "mineral acres" or sometimes "royalty acres" in expressing the fractional quantum to be conveyed or reserved. A broker customarily quotes a price "per mineral acre." The number of mineral acres which a party owns is determined by multiplying his total acreage by his fractional mineral ownership. Thus a full interest in 160 acres is  $(160 \times 1)$  160 mineral acres, and a  $1/4$  mineral interest in 160 acres is  $(1/4 \times 160)$  40 mineral acres. In the case of a party who owns a  $1/4$  interest in 160 acres and who desires to sell  $1/2$  of his  $1/4$  interest, the broker will frequently call for a deed conveying 20 mineral acres instead of an undivided  $1/8$  mineral interest.

Real trouble can be encountered if odd acreage is involved and the parties forget such odd acreage. If A, for example, owns a  $1/4$  interest in the  $NW\frac{1}{4}$  of Section 6, such quarter section actually consists of Lots 3, 4, and 5 and the  $SE\frac{1}{4}NW\frac{1}{4}$ , and instead of containing 160 acres contains less, for example 151.51 acres. If the grantor properly conveys in terms of fractions, *i.e.*,  $1/8$  to the broker and  $1/8$  to another party, no problem is confronted. But if he forgets about the odd acreage, as he usually does, and conveys first 20 mineral acres to the broker and then 20 mineral acres to a third party, somebody is going to be shortchanged and the grantor unhappily liable on his warranty for the simple reason that he did not own 40 mineral acres in the first place but only  $(1/4 \times 151.51)$  37.8775 mineral acres. This would be indeed distressing to the grantor if production were encountered on

this land subsequent to his conveyances. The term "mineral acres," serving no useful purpose in a deed, should be left to the brokers and kept out of legal instruments.

A final source of difficulty is the preparation of conveyances without first determining by an abstract examination what the grantor owns. Thus if a party thinking that he owns a mineral interest conveys a mineral interest, trouble will be encountered regardless of the provisions of the conveyance, if in fact the grantor only owns a royalty interest. Similarly, when a party wishes to convey a large tract of land and to reserve a one-half mineral interest or perhaps only a one-sixteenth non-participating royalty interest, ambiguity is almost bound to be present if the grantor owns different interests in different tracts of the total and has forgotten that in one tract he owns less than what he conveys. If the grantor, thinking he owns a full interest and desiring to reserve to himself a one-half interest, executes a warranty deed reserving a one-half interest, he will actually reserve nothing for himself in any tract in which he owned only one-half interest at the time of execution.<sup>18</sup> Certainly an abstract examination or a record check or title certificate prior to conveyancing is highly desirable.

Finally, it should be recognized that a mineral interest as distinguished from a royalty interest usually has a much more definitely accepted and clear meaning to both the professional and to the landowner dealing in such interests. Contrariwise, a royalty interest, except to the sophisticated, carries a vague, indefinite connotation. The word "royalty" is probably inherently ambiguous in spite of the many cases in which it has been said that royalty has a very definite and clear meaning.<sup>19</sup> If royalty were so obviously clear, there can be no explanation for the vast number of cases involving construction of royalty interests or the extensive legal texts and law review literature on the subject.<sup>20</sup> Therefore, a deed

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18. *Body v. McDonald*, 79 Wyo. 371, 334 P.2d 513 (1959).

19. *Bostwick, Oil and Gas Royalty Synonymous with Mineral Interest*, 1 WYO. L.J. 92 (1947).

20. *Colberg, Confusion of Terminology in Oil and Gas*, 10 WYO. L.J. 188 (1956); *Morris, Mineral Interests or Royalty Interests?*, 10 OIL & GAS INST. 259 (SW. LEGAL FDN. 1959); *Maxwell, A Primer of Mineral and Royalty Conveyancing*, 3 U.C.L.A. L. REV. 449 (1956). See also 1 WILLIAMS & MEYERS, OIL AND GAS LAW §§ 302-07 (1964).

containing a royalty grant or reservation should hesitantly be employed by an attorney and not utilized until he has satisfied himself that the parties know what they are doing and that a non-participating royalty is exactly what the parties desire. In utilizing any royalty deed form extreme care must be taken not only as to the fraction employed but that no unusual or extra rights are added to the royalty grant or royalty reservation. Such additional or unusual rights may result in reducing the owner's interest in gross production eightfold.

It is the superfluous language added to either a mineral or royalty conveyance which usually gives rise to problems. A fractional conveyance of a mineral interest will convey that fractional interest in any existing oil and gas lease as well as the same fractional right to execute and participate in any future leases. The simplest form of royalty deed will probably cause the least confusion and be more certain of a standard construction. Thus a grant of "an undivided ..... royalty of all the oil and all of the gas produced and saved" together with a statement that the royalty owner shall not participate in or be entitled to execute any oil and gas leases or receive any bonuses or delay rentals under either existing or future leases, is sufficient. It is not the carefully prepared and clearly thought out conveyance which makes case law. Litigation arises out of confusion, and frequently the court is required to interpret an instrument on the basis of determining the intent of the parties when as a matter of actual fact the parties had no intent and had given no thought whatsoever with respect to the problem.

These problems seldom if ever will frustrate the oil and gas lessee. Drilling operations have become so inherently expensive that no oil or gas well is drilled today without prior thorough title examination and title curative work on the part of the oil and gas lessee. The loser is the mineral or royalty interest owner who thought he owned one thing and found out later, usually after production or litigation, that he owned something less.