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Dave Hooper

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THE ENTIRETY CLAUSE AND PROPORTIONATE REDUCTION CLAUSE - - - CONFLICT AND A SOLUTION

Non-apportionment of royalties is by far the majority rule in the United States unless some provision is made in the lease providing for apportionment of royalties. One such provision is the entirety clause which provides for apportionment in cases where a lessor, subsequent to the lease, transfers or conveys a part of the leased premises. The proportionate reduction clause, however, applies in cases where the lessor owned less than he purported to lease, and upon discovery his royalty is decreased by the appropriate percentage. It would seem, therefore, since the entirety clause applies primarily to prospective conveyances and the proportionate reduction clause applies retrospectively, that there could be no conflict. That was the case before the arrival of another type of entirety clause which added the word "now" to the clause. With that addition, there is now a possibility of a conflict between the entirety clause and the proportionate reduction clause as demonstrated by the *Thomas Gilcrease Foundation v. Standard Oil & Gas Co.*¹ and *Jul-Tex Drilling Company v. Pure Oil Company*² cases to be discussed later.

The proportionate reduction clause is commonly found in a lease as follows:

If said lessor owns a less estate in the above described land than the entire and undivided fee simple estate therein, then the royalties and rentals herein provided shall be paid the lessor only in the proportion which his interest bears to the whole and undivided fee.³

The purpose of the clause is to provide for a reduction in payments to the lessor if he purports to lease more than his

1. *Thomas Gilcrease Foundation v. Stanolind Oil & Gas Co.*, 153 Tex. 197, 266 S.W.2d 850 (1964).

2. *Jul-Tex Drilling Co. v. Pure Oil Co.*, 201 F. Supp. 874 (D.D.C. 1962).

3. WILLIAMS & MYERS, OIL AND GAS TERMS, at 196 (1957).

interest. The clause does not, under the majority view, have the effect of an apportioning device.⁴ Representative of this view is the case of *Carlock v. Krug*,⁵ where the lease contained a proportionate reduction clause; there is no reference in the proportionate reduction clause to any future subdividing of the original tract. And absent any provision relating to apportionment, the general rule is that royalties accruing from production on a tract go to the owner or owners of that tract or interest. Generally the only time a proportionate reduction clause will apply is when an owner of, for example, a one-quarter undivided interest in a certain tract of land attempts to lease the whole tract as his own. Of course, his royalties will be reduced by three-fourths. Under the majority rule, an owner of 100 acres who leases that acreage and later sells 50 acres outright to another party will not share in the royalties if oil is produced on the acreage sold by virtue of the proportionate reduction clause in the lease. It was because of non-apportionment that the entirety clause was formulated and is now commonly found in leases.⁶

The general form of the entirety clause is:

If the leased premises are hereafter owned in severalty or in separate tracts, the premises, nevertheless, shall be developed and operated as an entirety, and royalties shall be paid to each separate owner in the proportion that the acreage owned by him bears to the entire leased acreage.⁷

Courts have had difficulty deciding cases which have an entirety clause in them and the issue is one of the division of royalties. Questions of intent,⁸ mistake, and reformation⁹ have entered in but overall the courts have found the clause to be valid, effective, and not against public policy.

Representative of those cases giving effect to the entirety clause are *Krone v. Lacy*¹⁰ and *Hoffman v. Sohio Petroleum*

4. McCoy, *The Entirety Clause—Its Current Use and Interpretation*, 12 ROCKY MT. MIN. L. INST. 317, 319 (1967).

5. 151 Kan. 407, 99 P.2d 858 (1940).

6. McCoy, *supra* note 4, at 320.

7. WILLIAMS & MYERS, *supra* note 3, at 85.

8. *Gypsy Oil Co. v. Schonwald*, 107 Okla. 253, 231 P. 864 (1924).

9. *Harley v. Magnolia Petroleum Oil Co.*, 378 Ill. 19, 37 N.E.2d 760 (1941).

Company.¹¹ In the *Krone* case the lessor owned a 2,400 acre tract of land, the lease on the land containing an entirety clause. Subsequent to the lease the lessor conveyed an undivided one-half interest in 160 acres and a one-fourth undivided interest in 320 acres to the same grantee. The conveyances were made "subject to" the lease. The 480 acres later started producing oil and the grantee claimed royalties of one-fourth and one-half on his interests. The Court, however, held that the grantee was entitled only to a one-fifteenth royalty by reason of the entirety clause in the deed. The grantee had a net interest of 80 acres in the 160 acre property and a net interest of 80 acres in the 320 acre property giving him a net total interest of 160 acres. This interest as compared to the leased premises of 2,400 acres gave the grantee one-fifteenth of the one-eighth royalty. In *Hoffman* the oil and gas lease containing an entirety clause covered the north half of a section of land. The tract was later partitioned with the east half going to the plaintiff and the west half to the defendant. These sales were made subject to the lease and when a producing well was drilled on the west half the Court held that plaintiff was entitled to his proportionate share of the royalties. It is important to note that in both of these cases the entirety clause was of the "now or hereafter" type. But since the partitions and conveyances were made subsequent to the lease no problem was encountered with the proportionate reduction clause.

The above cases and examples describe how the entirety clause and proportionate reduction clause work with respect to prospective and retrospective division of the leased premises. If, however, we taken an entirety clause with the words "If the leased premises *are now* or shall hereafter be owned in severalty or in separate tracts . . .," add a proportionate reduction clause to the lease and put them into a certain fact situation, problems can arise. One of the first cases to consider such a problem was *Thomas Gilcrease Foundation v. Stanolind Oil and Gas Company*.¹² The fact situation was

10. *Krone v. Lacy*, 168 Neb. 792, 97 N.W.2d 528 (1959).

11. *Hoffman v. Sohio Petroleum Co.*, 179 Kan. 84, 292 P.2d 1107 (1956).

12. *Thomas Gilcrease Foundation v. Stanolind Oil & Gas Co.*, *supra* note 1.

this: Gilcrease owned a three-fourths mineral interest in the northeast quarter of a section and a one-fourth interest in the northwest quarter of the section. The lease purported to cover the full interest in both quarters. Stanolind also had a lease of a one-fourth interest in each quarter from a bank and had an operating agreement with two other companies owning the remaining one-half interest in the northwest quarter. Both quarters had producing wells, but the wells on the northwest quarter were producing a much greater amount of oil.

The lease of the Gilcrease interest contained an entirety clause of the "now or hereafter type" and a proportionate reduction clause. The Gilcrease Foundation brought suit claiming a 50 percent royalty in the total leased area rather than a 75 percent royalty in the northeast quarter and a 25 percent royalty in the northwest quarter. The basis of its claim was that at the time of the lease the ownership was in "severalty or in separate tracts" notwithstanding the fact that their interest in both quarters was an undivided interest. Therefore, by virtue of the entirety clause they were entitled to a 50 percent royalty from the leased premises rather than a royalty figured on the basis of their ownership in each quarter.

The Supreme Court of Texas overruled Stanolind's arguments that the ownership was not in "severalty or in separate tracts," that the entirety clause could not be construed to enlarge the lessee's obligations and that the proportionate reduction clause operated to prevent Gilcrease from claiming a 50 percent royalty in a tract they had only a one-fourth interest in. The Court held that at the time the lease was made Gilcrease did own the premises "in severalty or in separate tracts" and that the entirety clause applied. This holding represents a situation where the entirety clause and the proportionate reduction clause conflict.

The real difficulty here arose because of the definition given by the Court to the term leased premise. The Court said: "We have been cited no authority to the effect that ownership in different undivided interests in segregated por-

tions of the leased premises does not qualify as an ownership in separate tracts."¹³ In other words, the Court broke away from the traditional view that the leased premises is only that tract where the producing well is located. Put still another way, "the leased premises are not the entire land, but only the interest therein subject to the lease."¹⁴ Had the proportionate reduction clause been applied, the Gilcrease royalty in the northwest quarter would have been set at 25 percent—their interest therein.

Another case considering this problem is *Jul-Tex Drilling Company v. Pure Oil Company*.¹⁵ Here, the Nelsons (defendants) owned the following interests: three-fourths interest in the west one-half of the northeast quarter of Section 3 (60 acres), the northeast quarter of Section 15 (160 acres), and one-fourth interest in the northwest quarter of Section 4 (40 acres), giving them a total of 260 mineral acres. The acres described in the lease totalled 400; the other interests are of no importance to this discussion. Section 4 is the only producing area in the lease. The Nelsons claimed a 260/400 interest in the royalties of the well by virtue of the entirety clause—a "now and hereafter" type—in the lease. This would have the effect of raising the lessee's royalty payments from 12½ percent to 17½ percent if the court found for the defendants.

The District Court of Colorado took a different approach from the one in *Gilcrease*, however, and held that the Nelsons were entitled to a one-fourth of one-eighth royalty by reason of their ownership in Section 4. They found the entirety clause inapplicable and applied the proportionate reduction clause instead. Their reason for this was that they construed leased premises as not including the entire land but restricting its meaning to the interest subject to the lease. Furthermore, they held as the Court in *Gilcrease* did that the land was not owned in its entirety by one lessor. So, as can be

13. *Id.* at 853.

14. O'Quinn, "Separately Owned Tracts Under Single Lease As Affected By Entirety Clause And Related Provisions," quoting Don Emery of the Oklahoma City Bar, EIGHTH ANNUAL INSTITUTE ON OIL AND GAS LAW AND TAXATION, 125, 157 (1957).

15. *Jul-Tex Drilling Co. v. Pure Oil Co.*, *supra* note 2.

seen from the *Gilcrease* and *Jul-Tex* cases, the conflict between the entirety clause and proportionate reduction clause arises by the interpretation of leased premises given by the Court.

Further decisions in this area, although there are only a few, indicate that the problem has not been resolved. The rule announced in the *Gilcrease* case is still the law in Texas, and at least one other court has indicated that if it were faced with a similar situation it would hold the same way. In *Stroud v. D-X Sunray Oil Co.*¹⁶ the Court said with reference to the entirety clause:

If the word 'now' or a word of similar meaning is used, the clause no doubt applies to minerals held in severalty at the time the lease is executed but not so where the phrase 'hereafter be owned' is used as it was in the clause under consideration.¹⁷

It was for this reason (the entirety clause being of the "hereafter" type rather than the "now and hereafter" type) that the Court in *Stroud* said it could not follow the holding in the *Gilcrease* case.

Thus we are left with two different approaches to the same problem. A closer examination of the holdings in the *Gilcrease* and *Jul-Tex* cases will indicate that the *Jul-Tex* theory is preferable. *Gilcrease* can be carried to an extreme to indicate how mistaken the holding is. Suppose eight landowners surround a tract of land in which they each own an undivided one-eighth interest. (See Appendix A.) Further, they each separately lease their own tract plus tract E to an oil company, under a lease with an entirety clause of the "now and hereafter" type. Under the *Gilcrease* ruling each landowner would be entitled to a nine-sixteenths of one-eighth royalty if oil were produced on tract E. That would total four and one-half times the one-eighth royalty traditionally paid. Conversely, if oil were produced on one of the individually owned tracts, the oil company would be required to pay only nine-sixteenths of one-eighth royalty.

16. 376 P.2d 1015 (Okla. 1962).

17. *Id.* at 1019

In either case the result would be inequitable. However, under the ruling in *Jul-Tex* (using the same example) if oil were produced on tract E, each owner of a one-eighth undivided interest would be entitled to a one-eighth of one-eighth royalty. Further, if oil were produced on one of the individually owned tracts, that owner would take the full one-eighth royalty. The only valid criticism that can be made of this distribution of royalties is that it might violate the intent of the parties. That is, the Court under the *Jul-Tex* holding would be applying the proportionate reduction clause rather than the entirety clause. Perhaps the only conclusion one can reach concerning the *Gilcrease* case and the use of the entirety clause is that, if the lessor does not own the same interest in every tract of land covered in the lease, an entirety clause of the "now or hereafter" type should not be used.¹⁸

Further solutions to this conflict can be found in the use of various other apportioning devices. They are: pooling or unitization agreements,¹⁹ proportionate reduction clauses (minority rule),²⁰ entirety clauses of the "hereafter" type,²¹ community leases,²² and space and drilling regulations.²³ This is by no means an exhaustive list of alternatives. The Court may also consider the duty of fair dealing and the intent of the parties.²⁴ Whatever alternative, if any, is employed will of course depend on the jurisdiction and the land and interests being leased. The above considerations may indicate that the lease, in many cases, will have to be tailor-made for the situation. Knowing that problems can and do arise by use of the entirety clause should be a warning to all that a standard lease form is not appropriate in many cases. This is especially applicable in those cases involving landowners with different interests in different tracts of land. In these

18. McCoy, *supra* note 4, at 368.

19. Wells v. Continental Oil Co., 244 Miss. 509, 142 So.2d 215 (1962).

20. Wettengal v. Gormley, 160 Pa. 559, 28 A. 934 (1894).

21. Stroud v. D-X Sunray Oil Co., *supra* note 14.

22. French v. George, 159 S.W.2d 566 (Tex. Civ. App. 1942).

23. Orders by state legislative bodies concerning where the well or wells must be drilled in order to get an efficient drain and how the owners are to share the royalties, *e.g.*, Oklahoma.

24. 2 WILLIAMS & MYERS, OIL AND GAS LAW, §§ 521.1-521.8 (Supp. 1969).

cases it may be wise to eliminate the entirety clause altogether and rely on some other apportioning device.²⁵

DAVE HOOPER

APPENDIX A

A	B	C
D	X—Producing Well E	F
G	H	I

Tracts A, B, C, D, F, G, H, and I are individually owned. Tract E is owned by the owners of the other tracts (one-eighth undivided interest each).

Each owner has a $\frac{9}{16}$ interest in leased area.

$$\frac{9}{16} \times 8 = \frac{72}{16} = 4\frac{1}{2} \times \frac{1}{8} \text{ royalty.}$$

25. Very helpful to this analysis besides those references previously noted was Hardwicke & Hardwicke, *Apportionment of Royalty to Separate Tracts: The Entirety Clause and the Community Lease*, 32 TEXAS L. REV. 660 (1954).