Wyoming Law Journal

Volume 13 | Number 3 Article 5

December 2019

Creation of Royalties Prior to Leasing

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As to the second situation discussed, where the mortgagee has given funds for construction, a state similar to Ohio's[32] would seem better than our present statute. This type of statute would give priority to the building loan mortgage but would make that priority depend on the rightful application of the building loan installments. Also a posting of notice on the lot or land could be required so that the lienors have actual notice of the existing mortgage.

As to the last proposition, the severance type statute[33] seems to be outdated and impractical. It seems that if the entire property was sold and each claimant given his pro rata share of the proceeds the additional expense of removing the building would be eliminated, the building would not be partially destroyed by the moving, a purchaser would pay more for the building as it was on the land, and thus neither party would be hurt to any appreciable extent.

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CREATION OF ROYALTIES PRIOR TO LEASING

A recent Colorado case has again raised questions as to the use of the expression "oil and gas royalty."[1] Some of the questions are: (1) what is it, (2) how do you create it, and (3) can it be created prior to the execution of an oil and gas lease. This note will be limited primarily to a consideration of the third question, although something must be said about the others before there can be any clear discussion of the selected question.

Ordinarily, the term "oil and gas royalty" refers to an expense-free share of the oil and gas.[2] It is expense free in the sense that it does not

32. Code of Ohio § 1311.14.
33. Ill. Rev. Stat. c. 82, § 16 (1949).
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1. Carlett v. Cox, ... Colo. ...., 333 P.2d 619 (1958).
2. U.S.: Mabee Oil and Gas Co. v. Hudson, 156 F.2d 450 (1946); Shinn v. Buxton, 154 F.2d 629 (1946); Patterson v. Texas Co., 131 F.2d 998, certiorari denied, 319 U.S. 761, 63 S.Ct. 1318, 87 L.Ed. 1712, rehearing denied, 320 U.S. 214, 63 S.Ct. 1455, 87 L.Ed. 1851 (1942); Wright v. Brush, 115 F.2d 265 (1940); Ark.: Hunson v. Ware, 224 Ark. 430, 274 S.W.2d 359 (1955); Longiro v. Machen, 217 Ark. 641, 232 S.W.2d 826 (1950); Cal.: Depuy v. McColgan, 122 Cal.App.2d 237, 246 P.2d 155 (1952); La Laguna Ranch Co. v. Dodge, 18 Cal.2d 132, 114 P.2d 315, 135 A.L.R. 546 (1941); Kan.: Randolph's Estate, 175 Kan. 685, 266 P.2d 315 (1954); Tegarden v. Beers, 175 Kan. 610, 265 P.2d 845 (1954); Robinson v. Robinson, 165 Kan. 494, 196 P.2d 159 (1948); Holland v. Shaffer, 162 Kan. 474, 178 P.2d 235, 173 A.L.R. 845 (1947); Skelly Oil Co. v. Cities Service Oil Co., 160 Kan. 226, 160 P.2d 246 (1945); Ky.: Maynard v. Ratliff, 297 Ky. 127, 179 S.W.2d 200 (1944); La.: Vincent v. Bullock, 192 La. 1, 187 So. 35 (1935); Mich.: People v. Blankenship, 305 Mich. 79, 8 N.W.2d 919 (1943); Mont.: Stokes v. Tutnet, ... Mont. ...., 328 P.2d 1096 (1958); New Silver Bell Mining Co. v. County, 129 Mont. 269, 284 P.2d 1012 (1955); Marias River Syndicate v. Big West Oil Co., 98 Mont. 254, 38 P.2d 599 (1934); Homestake Exploration Corp. v. Schoregge, 81 Mont. 604, 264 Pac. 388 (1928); Hinerman v. Baldwin, 67 Mont. 417, 215 Pac. 1103 (1923); N.M.: Duvall v. Stone, 54 N.M .27, 213 P.2d 212 (1949); Ohio: Pure Oil Co. v. Kindall, 116 Ohio St. 188, 156 N.E. 119 (1927); Okla.: Hinkle v. Gauntt, 210 Okla. 432, 206 P.2d 1001

have to bear a proportionate share of the costs of drilling and production.[3] This share is usually reserved for the landowner or mineral owner, as consideration for the grant of the right to explore for, and produce, the oil and gas.[4] Such a grant is usually in the form of an oil and gas lease. However, just as this grant need not be in the form of a lease, neither does the share have to be consideration for granting such a lease.[5] The right to receive a royalty is also thought of as one of the incidents of a mineral estate.[6] Some of these incidents include the right to go upon the land to explore for and produce the minerals, the right to execute a lease to a third person to explore for and produce the minerals, and the right to receive delay rentals, bonuses and royalties.[7]

Whether or not an oil and gas royalty is created depends upon the intention of the parties.[8] However, this intention is usually expressed in a written instrument, and the courts have frequently been called upon to construe the language used. This has given rise to much litigation, since the courts are not at all in agreement as to which words or expressions will accurately determine that the parties intended an oil and gas royalty.

Although oil and gas royalties are usually reserved as consideration for the execution of a lease, there have been numerous attempts to create such royalties by grants or reservations in deeds. These grants and reservations have been, at times, made prior to the execution of an oil and gas lease and thus, raise the question as to whether or not this can be done. It should be noted that these grants and reservations, as well as the leases,

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(1949); Tex.: Morriss v. First Nat. Bank of Mission, 249 S.W.2d 269 (1952); Watkins v. Slaughter, 144 Tex. 179, 189 S.W.2d 699 (1945); State Nat. Bank of Corpus Christi v. Morgan, 123 S.W.2d 1036, affirmed, 135 Tex. 509, 143 S.W.2d 757 (1938); Hill v. Roberts, 284 S.W. 246 (1926); Curlee v. Anderson & Patterson, 235 S.W. 622 (1921); see also: Jones: Non-participating Royalty, 26 Texas L. Rev. 569 (1948); Maxwell Richard C.: A Primer of Mineral and Royalty Conveyancing, 3 U.C.L.A. L. Rev. 449 (1956); Meyers, C. J.: The Effect of the Rule Against Perpetuities on Perpetual Non-participating Royalty and Kindred Interests, 32 Texas L. Rev. 369 (1954); Summers: Transfers of Oil and Gas Rents and Royalties, 10 Texas L. Rev. 1 (1931); 3A Summers on Oil and Gas, Section 571 (Perm. Ed. 1958); Sullivan: Handbook of Oil and Gas Law, p. 218 (1955).

3. Ibid.
4. Ibid.
5. Ala.: McCall v. Nettles, 215 Ala. 349, 37 So.2d 635 (1948); Ark.: Hunson v. Ware, 224 Ark. 430, 274 S.W.2d 359 (1955); Kan.: Shelly Oil Co. v. Cities Service Oil Co., 160 Kan. 226, 160 P.2d 246 (1945); Davis v. Hurst, 150 Kan. 130, 90 P.2d 1100 (1939); Lively v. Federal Land Bank of Louisville, 296 Ky. 133, 176 S.W.2d 264 (1943); La.: Gulf Refining Co. v. Hunter Co., 231 La. 1002, 93 So.2d (1957); Union Sulphur Co. v .Andraw, 217 La. 662, 47 So.2d 38 (1950); Miss.: Gulf Refining Co. v. Stanford, 202 Miss. 602, 30 So.2d 516, 173 A.L.R. 1099 (1947); Mont.: Stokes v. Tuenet, ___ Mont. ___, 328 P.2d 1096 (1958); N.M.: Durall v. Stone, 54 N.M. 27, 213 P.2d 212 (1949); Tex.: Harriss v. Ritter, 154 Tex. 474, 279 S.W.2d 845 (1955); Schlettler v. Smith, 128 Tex. 628, 101 S.W.2d 543 (1937); Wyo.: Denver Joint Stock v. Dixon, 57 Wyo. 523, 122 P.2d 842, 140 A.L.R. 1270 (1942).
6. Stokes v. Tutnet, ___ Mont. ___, 328 P.2d 1096 (1958); Krutxfeld v. Stevenson, 86 Mont. 463, 284 Pac. 553 (1930); Durall v. Stone, 54 N.M. 27, 213 P.2d 212 (1949); see also: 3A Summers on Oil and Gas, Section 599, p. 241 (Perm. Ed. 1958); Sullivan, Handbook of Oil and Gas Law, p. 208 (1955).
7. Ibid.
8. Supra notes 2 and 5.

are written, and the language used must be construed by the courts to determine the intention of the parties.

Three different answers to the question of whether or not an oil and gas royalty can be created prior to an oil and gas lease have evolved from the decisions of courts in different jurisdictions. The first to be considered will be the one expressed by the Wyoming Supreme Court;[9] the second, the answer given by the Kansas Supreme Court;[10] and the third, the answer expressed by the Colorado Supreme Court.[11]

The Wyoming Supreme Court has been faced with this question only once. In 1942 the Court held in *Denver Joint Stock Co. v. Dixon*[12] that an instrument purporting to grant or reserve a perpetual royalty interest prior to a lease of the oil and gas had been executed, created or reserved a perpetual non-participating royalty.[13]

The instrument in question purported to convey only the surface of the land, and at the same time granted one-sixteenth of the oil produced on the land. No right was granted or reserved to participate in the making of future leases. There was no lease for the production of oil and gas existing at that time.[14]

The Court cited *Summers on Oil and Gas*[15] in reaching its holding that ". . . a right to royalty may be reserved or granted before any lease is executed, and that such right is a perpetual non-participating royalty, if no right is granted or reserved to participate in the making of future leases."[16] The Court went on to say that such a royalty interest was an interest in land and, therefore, real property, but they made no further explanation of the nature of the perpetual non-participating royalty.[17] However, *Summers on Oil and Gas* in the same section cited by the Court, said:

> The term, non-participating, seems to have been used to indicate that the owner of the royalty does not participate in the execution of a lease for oil and gas or share in the cash bonus and delay rentals paid under a lease, thus distinguishing the royalty from a mineral interest. The term, perpetual, as applied to this royalty interest is not completely accurate, for such a royalty may be created for years, for a definite term of years, as long thereafter as oil or gas are produced from the land in paying quantities, and in perpetuity.[18]

The Court in the *Dixon* case appears to follow the theory that a

9. Denver Joint Stock v. Dixon, 57 Wyo. 523, 122 P.2d 842, 140 A.L.R. 1270 (1942).
10. Lathrop v. Eyestone, 170 Kan. 419, 227 P.2d 136 (1951).
11. Corlett v. Cox, ... Colo. ...., 333 P.2d 619 (1958).
12. Supra note 9.
13. Id. at 530, 122 P.2d at 844.
14. Ibid.
15. 3A Summers on Oil and Gas Law, Section 599, pp. 236, 237, 238 (Perm. Ed. 1958).
16. Denver Joint Stock v. Dixon, 57 Wyo. 523, 122 P.2d 844, 140 A.L.R. 1270 (1942).
17. Id. at 539, 122 P.2d at 848.
18. Supra note 16; see also: Jones: Non-participating Royalty, 26 Texas L. Rev. 569 (1948).

mineral fee is actually a bundle of rights or incidents which may be divided and separately granted or reserved. This theory is not novel. Among the jurisdictions accepting it are Alabama,[19] Arkansas,[20] Kentucky,[21] Louisana,[22] Mississippi, [23] Montana,[24] New Mexico,[25] and Texas.[26] As an example of this, the Texas Commission of Appeals in *Schittler v. Smith*[27]said that an oil and gas royalty may be created prior to the execution of an oil and gas lease. They also said that the royalty owner did not have the right to join in a future lease or receive a share of the bonuses and delay rentals under future leases, and that "it is well settled that a grantor may reserve minerals or mineral rights, and he may also reserve royalties, bonuses, and rentals, either one, more, or all."[28]

The Kansas Courts have never faced the question here involved, but they have formulated several rules which appear to be controlling. In *Lathrop v. Eyestone,*[29] the Court said that "royalty" is that part of the oil and gas payable to the lessor by the lessee out of oil and gas actually produced and saved; it does not include a perpetual interest in and to the oil and gas in place; and it is personal property.[30] The Court also stated that grants of royalties based on possible but wholly uncertain execution of future oil and gas leases do not render certain the vesting of title thereto within the period of the rule against perpetuities and are void.[31] It would therefore appear that any attempt to grant or reserve an oil and gas royalty before the execution of an oil and gas lease would be ineffective and void.

In *Lathrop v. Eyestone,*[32] the Court had to determine the effect of two instruments which were subject to an existing lease and which purported to convey fractional royalty interests under the existing lease and also fractional royalty interests under any future leases, but reserving the exclusive right to execute such future leases. The Court in cancelling these two instruments said:

> Appellant or future fee owners might never execute another lease. There is nothing in any of the instruments which imposes a duty on them to do so. Under the last two instruments, at least, the fee title owner would not be precluded from doing his own developing. . . . Morever there is no limitation of time within which a future lease would be required to be executed, if one were

19. McCall v. Nettles, 251 Ala. 349, 37 So.2d 635 (1948).
20. Hunson v. Ware, 224 Ark. 430, 274 S.W.2d 359 (1955).
21. Lively v. Federal Land Bank of Louisville, 296 Ky. 133, 176 S.W.2d 264 (1943).
22. Gulf Refining Co. v. Hunter Co., 213 La. 1002, 93 So.2d 537 (1957); Union Sulphur Co. v. Andraw, 217 La. 662, 47 So.2d 38 (1950).
23. Gulf Refining Co. v. Stanford, 202 Miss. 602, 30 So.2d 516, 173 A.L.R. 1099 (1947).
24. Stokes v. Tutnet, ... Mont. ...., 328 P.2d 1096 (1958).
25. Durall v. Stone, 54 N.M. 27, 213 P.2d 212 (1949).
26. Harriss v. Ritter, 154 Tex. 474, 279 S.W.2d 845 (1955); Schlittler v. Smith, 128 Tex. 628, 101 S.W.2d 543 (1937).
27. 128 Tex. 628, 101 S.W.2d 543 (1937).
28. Id. at 629, 101 S.W.2d at 544.
29. Lathrop v. Eyestone, 170 Kan. 419, 227 P.2d 136 (1951).
30. Id. 227 P.2d at 141.
31. Id. 227 P.2d at 143.
32. Id. 227 P.2d at 140.

> actually executed. It is, therefore, wholly problematical when, if ever, such an interest under future leases would vest. Such a grant violates the rule against perpetuities, a rule against too remote vesting.[33]

It would therefore appear that the Kansas courts do recognize the theory that a mineral fee is actually a bundle of rights or incidents which may be divided and separately granted or reserved. But they differ from Wyoming in calling such a "royalty" interest personal property and subjecting it to the rule against perpetuities. Kansas is at present the only state that follows this holding; however, at least one case in California[34] could be construed to hold the same thing.

The Supreme Court of Colorado takes a view entirely different from that expressed by either Wyoming or Kansas Courts. In a recent case, *Corlett v. Cox,*[35] the court was asked to determine the nature of the interest created by a reservation in a deed executed prior to an oil and gas lease. The instrument in question said: ". . . hereby reserves six and one quarter percent of all gas, oil, and minerals that may be produced from any or all the above-mentioned land, or in other words reserves ½ of the usual ⅛ royalty." Following the warranty clause in the deed, there appears: ". . . excepting the (6¼) percent of the gas, oil, etc., mentioned above which is reserved as above-stated as part of the payment of said land." The supreme court affirmed the trial court's decree that the "minerals, including the right to lease, receive bonus, delay rentals, and exercise all other proprietary and executive rights thereunder were owned as follows: Mark T. Cox, III, 15/16, and Alice B. Corlett and Edna Holcom McLaughin 1/16."[36]

In reaching this decision, the court cited *Toothman v. Cortney*[37] saying that this ". . . is a well reasoned case and we believe decisive of the present inquiry."[38] The court in *Toothman v. Courtney* said:

> . . . though he did not reserve by name the oil in place, or any part of it, his reservation of all the rental or royalty to be derived from it compels the court to hold, by construction of the instrument, that it vests in him the title to that thing, the beneficial use whereof has been reserved; namely, the oil in place.[39]

The theory of this case dates back to the dictum of Lord Coke in *Coke on Lyttleton*[40] where Lord Coke said that the grant of the profits of the land amounted to a grant of the land itself. Since *Toothman v. Courtney* was decided, the West Virginia courts have expanded this rule to mean that a grant or reservation of a share of production amounts to a grant or reser-

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33. Id. 227 P.2d at 143.
34. Dallapi v. Campbell, 45 Cal.App.2d 541, 114 P.2d 646 (1941).
35. Corlett v. Cox, ___ Colo. ___, 333 P.2d 619 (1958).
36. Id. 333 P.2d at 620.
37. 62 W.Va. 168, 58 S.E. 915 (1907).
38. Supra note 35.
39. 62 W.Va. 168, 58 S.E. 916 (1907).
40. 1 Co. Litt. 45 (1628).

vation of a proportionate fee interest in the minerals in place, including all the incident of a mineral fee; the right to lease, develop, royalties, bonuses, and delay rentals.[41] The latter construction of the rule of *Toothman v. Courtney* is apparently that which the Colorado court is relying upon.

It should be pointed out at this time that the Colorado court does not expressly preclude the creation of royalty interests prior to the execution of an oil and gas lease. The court seems to say that the above is a rule of construction which is to be used to determine the intentions of parties. In this respect the court expressed its concern for the intention of the parties when it said:

> The intention of the parties to a deed is to be ascertained, if possible, from its language, not as it is presented in particular sentences or paragraphs, but according to its effect when viewed as an entirety.[42]

In determining the intention of the parties, the court apparently felt that the language used was ambiguous. Not only did the court look at the language,[43] but it also scrutinized the conduct of the parties,[44] and finally cited the foregoing rule of construction as being decisive.[45] Such action on the part of the court leaves the door open for this question: Can parties in Colorado express their desires so as to sever the right to share in production from the mineral fee?

The answer would appear to be no, for if such clear language as was used in the reservation in this case was not sufficient, what clearer expression of an intention to create an oil and gas royalty could be written? There is also the possibility that the court felt that the instrument was clear upon its face, but with the admission of the extrinsic evidence that there was no lease in effect, the instrument was actually ambiguous. Since it was ambiguous, the above rule of construction would again be used. Therefore, although the court did not expressly preclude the creation of a royalty before a lease, it has done so by implication.

There are, perhaps, many valid reasons why either the Wyoming or the Kansas view should be followed. However, the same cannot be said about the Colorado view as expressed in *Corlett v. Cox*.[46] First, the Colorado Supreme Court implied, without saying so, that the language used in the instrument was ambiguous. As was noted above, there is not much possibility that a clearer expression of the intention to create an oil and gas royalty could be formulated. Second, the Colorado Supreme Court spoke of the parties' conduct as being expressive of their intention. The parties, subsequent to the execution of the reservation, entered into an

41. Union Carbon Co. v. Presley, 126 W.Va. 636, 29 S.E.2d 466 (1944).
42. Supra note 35.
43. Ibid.
44. Ibid.
45. Ibid.
46. Ibid.

oil and gas lease. This, the court felt showed that the parties understood that they were co-tenant owners of the mineral fee.[47] However, an examination of the records of the case will disclose that the court failed to note that, in signing the lease, the "oil and gas royalty" owners specifically disclaimed any rights beyond a cost free share of the production and stated that they were ratifying the lease solely for the convenience of the lessors. Third, if the court felt that this was a problem of construction they failed to explore the parties understanding of a "royalty" other than to speak of their conduct in signing the subsequent lease. They also failed to explore the common acceptance of the term used. Fourth, by using this rule of construction, the court not only precluded the creation of an oil and gas royalty prior to the execution of an oil and gas lease, but they also ignored the basic idea that an oil and gas royalty is an expense-free share of production which may be separately granted or reserved, with the mineral owner retaining the right to lease, explore, develop, and receive bonuses and delay rentals. The latter is the direct result of the holding that an attempted creation of an oil and gas royalty amounts to the creation of a mineral interest. Such a rule, based upon old common law thinking, fails to recognize current developments and practices, and the desirability of splitting up and separately granting and reserving the incidents of a mineral fee.[48] Finally, the holding that a grant of a royalty amounts to a grant of the oil and gas itself has the practical effect of clothing the "royalty" owner with the incidents of mineral ownership. As a result the "royalty" owner would have the right to lease his undivided share of the oil and gas and the mineral fee owner would be precluded from transferring any share of the prospective oil and gas production which does not include the right to lease. Such a result is contrary to the results of jurisdictions of far greater experience in oil and gas conveyancing[49] and it is unfortunate that the Colorado Supreme Court does not follow these jurisdictions.

SILAS R. LYMAN

JURY TRIAL IN WYOMING CASES CONTAINING LEGAL AND EQUITABLE ISSUES

Rule 38 (a) of the recently adopted Wyoming Rules of Civil Procedure preserves the right to jury trial, which is impliedly guaranteed by the Wyoming Constitution.[1] The rule provides:

47. Ibid.
48. Jones: Non-participating Royalty, 26 Texas L. Rev. 569 (1948); Sullivan: Handbook of Oil and Gas Law, pp. 218, 219, 220 (1955); 3A Summers on Oil and Gas, Section 599, pp. 240, 241, 242, 243 (Perm. Ed. 1958); Walker: Developments in the Law of Oil and Gas, 25 Texas L. Rev. 1 (1946).
49. Supra notes 19 through 26.

1. Wyoming Const. Art. 1, § 9.