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Common Problems in Conveying Oil and Gas Interests.

Sharon Callaway Dittfurth

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COMMENTS

COMMON PROBLEMS IN CONVEYING OIL AND GAS INTERESTS

Sharon Callaway Dittfurth

I. Introduction	825
II. Mineral - Royalty Distinction	827
III. Fractional Interests	828
A. Fractional Royalty Interests	829
B. Fractional Mineral Interests	830
1. <i>Hooks v. Neill</i>	830
2. <i>Duhig v. Peavy-Moore Lumber Co.</i>	831
3. Exceptions to the <i>Duhig</i> Rule	832
4. Drafting Suggestions	836
IV. Assignments	838
V. Top Leasing	842
VI. Conclusion	844

I. INTRODUCTION

Few attorneys who practice long in the state of Texas are likely to avoid encountering a conveyance of an oil and gas interest. In addition to the transfer or drafting of oil and gas leases, mineral interests in general are frequently important elements in real property conveyances.¹ An oil and gas interest may be transferred by deed,² reservation or exception in

1. The term "oil and gas" will be used throughout this comment. It should be noted that most of the discussion involves "mineral interests" which usually include oil and gas. The majority rule, followed by Texas, is that oil and gas are included in the term "mineral" unless there is evidence of a contrary intention. *See, e.g., Anderson & Kerr Drilling Co. v. Bruhlmeier*, 134 Tex. 574, 582, 136 S.W.2d 800, 804 (1940); *Guinn v. Acker*, 451 S.W.2d 549, 551 (Tex. Civ. App.—Tyler 1970), *aff'd*, 464 S.W.2d 348 (Tex. 1971); *Atwood v. Rodman*, 355 S.W.2d 206, 212 (Tex. Civ. App.—El Paso 1962, writ ref'd n.r.e.). *See generally* 1 E. KUNTZ, A TREATISE ON THE LAW OF OIL AND GAS § 13.3, at 300 (1962).

2. *See, e.g., Waggoner Estate v. Wichita County*, 273 U.S. 113, 117 (1927); *Hager v.*

a deed,³ lease,⁴ or assignment.⁵ In Texas, the oil and gas lease differs from the usual lease in that it is viewed as a present conveyance of an interest in land vesting in the lessee a determinable fee in the oil and gas in place.⁶ Since Texas follows the rule of ownership of oil and gas in place,⁷ oil and gas are considered part of the realty and are, therefore, capable of severance, conveyance, lease, and taxation.⁸ The right of ownership in place is modified by the "law of capture," which specifies that a property owner has the right to all of the oil and gas which flows from a well on his land, including oil and gas which has migrated to his land from beneath

Stakes, 116 Tex. 453, 471, 294 S.W. 835, 842 (1927); *States Oil Corp. v. Ward*, 236 S.W. 446, 448 (Tex. Comm'n App. 1922, judgment adopted). A mineral deed is a conveyance of an interest in minerals in, on, or under the described land wherein grantee is given the operating rights to produce the minerals on the land. See H. WILLIAMS & C. MEYERS, *MANUAL OF OIL AND GAS TERMS* 429 (5th ed. 1981). A mineral deed is to be distinguished from a lease and a royalty deed, which conveys a royalty interest, usually one out of every eight barrels of oil produced. See *id.* at 660.

3. See, e.g., *Humphreys-Mexia Co. v. Gammon*, 113 Tex. 247, 256, 254 S.W. 296, 299 (1923); *Perkins v. Kemp*, 274 S.W.2d 892, 894 (Tex. Civ. App.—Eastland 1954, writ ref'd n.r.e.); *Lyles v. Dodge*, 228 S.W. 316, 317 (Tex. Civ. App.—Amarillo 1921, no writ).

4. See *Yates v. Gulf Oil Corp.*, 182 F.2d 286, 290 (5th Cir. 1950) (applying Texas law). A lease is an instrument by which the working interest is created in the minerals. See H. WILLIAMS & C. MEYERS, *MANUAL OF OIL AND GAS TERMS* 388 (5th ed. 1981). For a distinction between a lease and deed, see Comment, *Determination Of Whether An Instrument Is A Lease Or An Absolute Conveyance Of Oil And Gas*, 25 TEXAS L. REV. 157, 160-61 (1946).

5. See, e.g., *Knight v. Chicago Corp.*, 144 Tex. 98, 103, 188 S.W.2d 564, 566 (1945); *Cowden v. Broderick & Calvert*, 131 Tex. 434, 437, 114 S.W.2d 1166, 1167-68 (1938); *Tenant v. Dunn*, 130 Tex. 285, 290-91, 110 S.W.2d 53, 56 (1937).

6. See, e.g., *Stephens County v. Mid-Kansas Oil & Gas Co.*, 113 Tex. 160, 169, 174-75, 254 S.W. 290, 293, 295 (1923); *Texas Co. v. Davis*, 113 Tex. 321, 331, 254 S.W. 304, 306 (1923); *Jones v. Bevier*, 59 S.W.2d 945, 948 (Tex. Civ. App.—Beaumont 1933, writ ref'd).

7. The ownership in place theory provides that the landowner owns the oil and gas in place beneath the surface of his land. See H. WILLIAMS & C. MEYERS, *MANUAL OF OIL AND GAS TERMS* 521 (5th ed. 1981). For a general discussion of jurisdictions which follow ownership in place theory, see 1 H. WILLIAMS & C. MEYERS, *OIL AND GAS LAW* § 203.3, at 44-50 (1978). Other theories include the non-ownership theory that no one owns the oil and gas until it is produced and the interest is, therefore, an incorporeal one. See 1 H. WILLIAMS & C. MEYERS, *OIL AND GAS LAW* § 203.1, at 33-39 (1978); H. WILLIAMS & C. MEYERS, *MANUAL OF OIL AND GAS TERMS* 472 (5th ed. 1981). A third approach is the qualified ownership theory whereby owners whose land overlays a producing formation have correlative rights. See 1 H. WILLIAMS & C. MEYERS, *OIL AND GAS LAW* § 203.2, at 39-44 (1978); H. WILLIAMS & C. MEYERS, *MANUAL OF OIL AND GAS TERMS* 609 (5th ed. 1981). A fourth theory is that of ownership of strata. Even though the owner does not own the oil and gas in place, he does own the formation containing the oil and gas. See 1 H. WILLIAMS & C. MEYERS, *OIL AND GAS LAW* § 203.4, at 50-52 (1978); H. WILLIAMS & C. MEYERS, *MANUAL OF OIL AND GAS TERMS* 521-22 (5th ed. 1981).

8. See, e.g., *Ryan Consolidated Petroleum Corp. v. Pickens*, 155 Tex. 221, 239, 285 S.W.2d 201, 208 (1955); *Elliff v. Texon Drilling Co.*, 146 Tex. 575, 580, 210 S.W.2d 558, 561 (1948); *Texas Co. v. Daugherty*, 107 Tex. 226, 236, 176 S.W. 717, 720 (1915).

another's land. Likewise, an adjoining landowner may exercise his right of capture over oil or gas that migrates to his land, and thereby acquire title to it.⁹ Because oil and gas is considered part of the realty, ownership passes to the grantee with the conveyance of the surface unless specifically reserved or excepted.¹⁰

Since a conveyance of oil and gas in place is a conveyance of an interest in land,¹¹ the general statutes regulating conveyances¹² govern the transfer of mineral interests.¹³ Similarly, instruments transferring interests of oil and gas and other minerals are generally subject to the rules of construction of written contracts for the sale of land.¹⁴

This comment focuses on the recurring problems of conveying fractional oil and gas interests¹⁵ and the problems associated with the assignment of working interests.¹⁶

II. MINERAL-ROYALTY DISTINCTION

The type of interest created by a conveyance and the corresponding

9. See, e.g., *Halbouty v. Railroad Comm'n*, 163 Tex. 417, 433, 357 S.W.2d 364, 374, *cert. denied*, 371 U.S. 888 (1962); *Elliff v. Texon Drilling Co.*, 146 Tex. 575, 581, 210 S.W.2d 558, 561 (1948); *Brown v. Humble Oil & Ref. Co.*, 126 Tex. 296, 305, 83 S.W.2d 935, 940 (1935).

10. See, e.g., *Harris v. Currie*, 142 Tex. 93, 98, 176 S.W.2d 302, 304 (1943); *Schlittler v. Smith*, 128 Tex. 628, 630, 101 S.W.2d 543, 544 (1937); *Hill v. Roberts*, 284 S.W. 246, 249 (Tex. Civ. App.—Fort Worth 1926, no writ).

11. See, e.g., *Caruthers v. Leonard*, 254 S.W. 779, 781 (Tex. Comm'n App. 1923, judgment adopted); *Elder v. Miller*, 116 S.W.2d 1171, 1173 (Tex. Civ. App.—Waco 1938, no writ); *Sibley v. Pickens*, 273 S.W. 897, 898 (Tex. Civ. App.—Amarillo 1925, no writ).

12. TEX. REV. CIV. STAT. ANN. arts. 1288-1301 (Vernon 1980).

13. See, e.g., *Smith v. Sorelle*, 126 Tex. 353, 357, 87 S.W.2d 703, 705 (1935) (statute of frauds applicable to mineral deed); *Joplin v. Nystel*, 212 S.W.2d 869, 871 (Tex. Civ. App.—Amarillo 1948, no writ) (oil and gas in place regarded as realty is subject to rules governing conveyance of real estate); *Lambert v. Gant*, 290 S.W. 548, 550 (Tex. Civ. App.—Fort Worth 1926, no writ) (signature of wife on oil and gas lease in which no homestead claim unnecessary).

14. See R. HEMINGWAY, *THE LAW OF OIL AND GAS* § 1.3, at 10 (1971). Under modern conveyancing rules the document's construction is governed by the intent of the parties expressed in the four corners of the document. See *Pan Am. Petroleum Corp. v. Robinson*, 405 S.W.2d 698, 700 (Tex. Civ. App.—Eastland 1966, writ ref'd n.r.e.); see also *Humphreys-Mexia Co. v. Gammon*, 113 Tex. 247, 262, 254 S.W. 296, 302 (1923) (general rules of construction dictate that the intent of the parties controls).

15. References will for the most part be confined to Texas case law. For other jurisdictions' treatment of any given area, see R. HEMINGWAY, *THE LAW OF OIL AND GAS* (1971) 1 E. KUNTZ, *A TREATISE ON THE LAW OF OIL AND GAS* (1962) 1 W. SUMMERS, *THE LAW OF OIL AND GAS* (2d ed. 1954) 1 H. WILLIAMS & C. MEYERS, *OIL AND GAS LAW* (1978); 2 H. WILLIAMS & C. MEYERS, *OIL AND GAS LAW* (1981).

16. See H. WILLIAMS & C. MEYERS, *MANUAL OF OIL AND GAS TERMS* 838 (5th ed. 1981). The "working interest" is the operating interest wherein the owner may exploit the minerals on the land and share in the revenues from the venture. See *id.* at 838.

rights depend upon the language in the instrument. For this reason it is important to distinguish a mineral interest from a royalty interest. In general, a mineral estate includes the power to develop the minerals or the power to authorize others to do so by lease, as well as the right to receive bonuses, delay rentals, royalties, shut-in payments, and, in general, all payments made under the lease.¹⁷ It is distinguished from a royalty interest in that it includes operating rights.¹⁸ A royalty interest is simply the right to receive a proportionate share of the oil and gas produced, free of expenses of production.¹⁹ Care must be taken not to use the terms interchangeably as there are distinct rights that characterize each.²⁰ The draftsman of an oil and gas conveyance, therefore, must use precise and exact language to insure that his client receives the rights and benefits he thought he was creating by the conveyance.

III. FRACTIONAL INTERESTS

One of the most common problems in oil and gas litigation involves the failure of the draftsman to use precise language in creating surface, mineral or royalty interests of less than full fee simple.²¹

17. See R. HEMINGWAY, *THE LAW OF OIL AND GAS* § 2.1, at 21 (1971). A "bonus" is usually cash paid to the landowner in consideration for the execution of an oil and gas lease. See H. WILLIAMS & C. MEYERS, *MANUAL OF OIL AND GAS TERMS* 65 (5th ed. 1981). "Delay rentals" are sums paid by the lessee to the lessor in order to defer beginning drilling operations during the primary term. See *id.* at 175. A "royalty" is the landowner's share of production free of the expenses of production, usually $\frac{1}{8}$ production or one out of every eight barrels of oil produced. See *id.* at 656. "Shut-in royalty payments" are a means of maintaining a lease when a producing well in paying quantities is shut in, usually because of lack of a market for the oil or gas. See *id.* at 700.

18. See *Schlittler v. Smith*, 128 Tex. 628, 630-31, 101 S.W.2d 543, 544 (1937) (recognition of different meanings of "royalty" and "mineral interest"); *Miller v. Speed*, 259 S.W.2d 235, 241 (Tex. Civ. App.—Eastland 1952, no writ) (royalty refers to interest in oil and gas produced, not oil and gas in place). An "operating right" is the right to conduct operations for oil and gas, such as exploring, surveying, drilling, or any action directed to production of the oil and gas. See H. WILLIAMS & C. MEYERS, *MANUAL OF OIL AND GAS TERMS* 507-08 (5th ed. 1981).

19. See *Alamo Nat'l Bank v. Hurd*, 485 S.W.2d 335, 338 (Tex. Civ. App.—San Antonio 1972, writ ref'd n.r.e.); H. WILLIAMS & C. MEYERS, *MANUAL OF OIL AND GAS TERMS* 661 (5th ed. 1981). The following phrases have been interpreted as showing an intention to reserve a royalty interest rather than a mineral interest: minerals "from actual production" and an interest in minerals "produced, saved and made available for market." See *Grissom v. Guestersloh*, 391 S.W.2d 167, 171 (Tex. Civ. App.—Amarillo 1965, writ ref'd n.r.e.).

20. See generally 1 H. WILLIAMS & C. MEYERS, *OIL AND GAS LAW* §§ 302-307, at 445-557 (1978).

21. See *id.* § 308, at 575-76 (1978).

A. Fractional Royalty Interests

For more than fifty years, $\frac{1}{8}$ was the standard royalty so that a conveyance granting a one-half interest in the royalty on a certain lease was synonymous with $\frac{1}{2}$ of $\frac{1}{8}$ or a $\frac{1}{16}$ interest in the oil and gas produced.²² In recent years royalties of $\frac{1}{6}$, $\frac{3}{16}$, or even percentage interests like 22.5% have become common,²³ creating problems in construing deeds which were executed when $\frac{1}{8}$ was the standard royalty but which now include new leases for royalties exceeding $\frac{1}{8}$. If the conveyance states " $\frac{1}{2}$ of the $\frac{1}{8}$ th royalty," the grantee receives a $\frac{1}{16}$ interest despite subsequent leases for more than a $\frac{1}{8}$ royalty since subsequent leases will not override specific language in the deed.²⁴

A problem arises, however, when in the conveyance the interest is described both as a fraction of $\frac{1}{8}$ and as a fraction of the royalty. Such was at issue in *Farmers Canal Co. v. Potthast*.²⁵ In that case the granting clause conveyed an "undivided one-fourth ($\frac{1}{4}$ th) interest" in the royalty, but the clause reserving executive rights provided for the grantee to receive "one-fourth ($\frac{1}{4}$ th) of the one-eighth ($\frac{1}{8}$ th) royalty."²⁶ Thirty years later a lease was executed providing for a $\frac{1}{6}$ royalty.²⁷ Controversy arose as to whether grantee received $\frac{1}{4}$ of $\frac{1}{8}$ or $\frac{1}{4}$ of the fractional royalty reserved by grantors in future leases.²⁸ The court decided that grantee receives $\frac{1}{4}$ of $\frac{1}{6}$ on the theory that language of the granting clause prevails over other provisions.²⁹ In *Brown v. Havard*³⁰ litigation centered around a clause in a 1963 warranty deed reserving an "undivided one-half non-participating royalty (Being equal to, not less than an undivided $\frac{1}{16}$ th) of all the oil, gas and other minerals . . ."³¹ In 1973 a lease with a $\frac{3}{8}$ royalty was executed and the Browns claimed a $\frac{3}{16}$ royalty interest.³²

22. Smith, *Conveyancing Problems*, STATE BAR OF TEXAS PROFESSIONAL DEVELOPMENT PROGRAM—ADVANCED OIL, GAS AND MINERAL LAW COURSE G-1, G-1 (1981).

23. See *id.* at G-2.

24. See *Canter v. Lindsey*, 575 S.W.2d 331, 335 (Tex. Civ. App.—El Paso 1978, writ ref'd n.r.e.); *Helms v. Guthrie*, 573 S.W.2d 855, 856-57 (Tex. Civ. App.—Ft. Worth 1978, writ ref'd n.r.e.).

25. 587 S.W.2d 805 (Tex. Civ. App.—Corpus Christi 1979, writ ref'd n.r.e.).

26. See *id.* at 807.

27. See *id.* at 807.

28. See *id.* at 806.

29. See *id.* at 809. Dean Smith argues that such a result more accurately reflects the general intent of the parties—that the royalty owner shares in the full royalty rather than being limited to one-eighth and that $\frac{1}{8}$ was used merely because it was the standard at the time the deed was executed. See Smith, *Conveyancing Problems*, STATE BAR OF TEXAS PROFESSIONAL DEVELOPMENT PROGRAM—ADVANCED OIL, GAS AND MINERAL LAW COURSE G-1, G-1.

30. 593 S.W.2d 939 (Tex. 1980).

31. *Id.* at 940.

32. See *id.* at 941.

The majority of the supreme court held the clause to be ambiguous because of the parenthetical phrase³³ and, thus, supported the jury finding that the intent of the parties was to reserve 1/16.³⁴ Joined by two other justices in his dissent, Justice McGee interpreted the parenthetical phrase as an indication that the Browns had contemplated future leases and had attempted to ensure that their royalty interest would never be less than the 1/16 interest under the current lease.³⁵ It was, therefore, an unambiguous minimum, rather than a maximum, provision.

The real problem presented to the draftsman by *Havard* is that the attorney in that situation attempted a careful drafting of the royalty reservation by recognizing that future leases might call for a different royalty interest than the existing lease and yet the result was to limit rather than enlarge his client's benefits.³⁶ The answer, perhaps, is a seemingly simple one: always review the language of any conveyance to ensure that it clearly and unambiguously sets forth what the grantor intends to convey or reserve. When drafting a conveyance involving a royalty, the attorney should keep in mind the possibility of future leases at different royalty interests. In order to take advantage of possible higher royalty interests, the language should refer to a fraction of a royalty interest of any future leases, rather than a fraction of $\frac{1}{8}$, which would limit the interest. In reviewing any royalty interests held by a client, an attorney should determine whether under the deed the royalty owner is entitled to the higher royalty share provided for in a subsequent lease.

B. Fractional Mineral Interests

Another area of confusion involves a grantor, owning a fraction of the entire fee in the land, who conveys the surface and reserves a fraction of the minerals. Has he reserved a fraction of 100% of the minerals or a fraction of his fractional interest?

1. *Hooks v. Neill*

When drafting a reservation clause for a grantor owning less than a 100% interest, the draftsman should refer to the physical land in the clause, not the fractional interest. *Hooks v. Neill*³⁷ illustrates the conse-

33. The majority viewed the position of the comma in the parenthetical phrase as particularly responsible for rendering the phrase capable of two interpretations. *See id.* at 942.

34. *See id.* at 942. The trial court held the deed was unambiguous and awarded the Browns a 3/16 interest. Finding that the reservation was ambiguous, the court of civil appeals reversed the judgment non obstante veredicto. *See id.* at 941.

35. *See id.* at 946 (McGee, J., dissenting).

36. *See id.* at 946 (McGee, J., dissenting).

37. 21 S.W.2d 532 (Tex. Civ. App.—Galveston 1929, writ ref'd).

quences of failure to make clear such a reference. In *Hooks* the owner of an undivided one-half interest in the land executed a general warranty deed in which the granting clause conveyed all the owner's rights to the tract of land. A subsequent provision, however, reserved "one thirty-second part of all oil on and under the said land and premises herein described and conveyed" ³⁸ Was the reservation 1/32 of the entire tract or 1/32 of the one-half undivided interest? That is, was the reference to the grantor's fractional interest or to the physical land? ³⁹ The term "conveyed" was viewed as a reference to the granting clause and, thus, limited the interest to 1/32 of one-half instead of 1/32 of the whole. ⁴⁰ On the other hand, in *King v. First National Bank of Wichita Falls*, ⁴¹ the reservation clause in a warranty deed conveying a one-half interest in the land provided that $\frac{1}{8}$ of the $\frac{1}{8}$ royalty in oil and gas produced "from the herein above described land" would be paid to the grantor. ⁴² *Hooks* was distinguished on the grounds that the reservation clause in *King* did not refer to the land "conveyed," but rather to the land described, that is, the whole tract; ⁴³ therefore, the grantor was entitled to $\frac{1}{8}$ of the total royalty, not $\frac{1}{8}$ of $\frac{1}{2}$ of the royalty. ⁴⁴

In order to avoid the curtailment of the grantor's benefits under an oil and gas reservation, the following reservation clause is suggested:

Grantor reserves herefrom $\frac{1}{2}$ of all oil, gas and other minerals in, under and that may be produced from the above described *physical land*, as distinguished from any interest in said land. ⁴⁵

2. *Duhig v. Peavy-Moore Lumber Co.*

A more difficult problem, however, is presented by the failure of the

38. *Id.* at 534.

39. See Masterson, *Double Fraction Problems In Instruments Involving Mineral Interests*, 22 Sw. L.J. 281, 282 (1957).

40. See *Hooks v. Neill*, 21 S.W.2d 532, 538-39 (Tex. Civ. App.—Galveston 1929, writ ref'd). The same result was reached in a later case in which the reservation referred to minerals on "land and premises herein conveyed." See *Dowda v. Hayman*, 221 S.W.2d 1016, 1017 (Tex. Civ. App.—Fort Worth 1949, writ ref'd).

41. 144 Tex. 583, 192 S.W.2d 260 (1946).

42. See *id.* at 584, 192 S.W.2d at 261.

43. See *id.* at 587, 192 S.W.2d at 263. Professor Masterson considered this a tenuous distinction at best, pointing out that if *King* effects the parties' intentions, then *Hooks* probably did not. See Masterson, *Double Fraction Problems In Instruments Involving Mineral Interests*, 11 Sw. L.J. 281, 282-83 (1957).

44. See *King v. First Nat'l Bank*, 144 Tex. 583, 587, 192 S.W.2d 260, 263 (1946).

45. Courtney, *Conveyancing And Assignments—Common Problems In the Transfer Of Oil, Gas And Other Mineral Interests*, STATE BAR OF TEXAS INSTITUTE—OIL AND GAS LAW FOR THE GENERAL PRACTITIONER B-1, B-8 (1980).

draftsman to except all outstanding interests in conveyances by owners of less than the entire fee. For example, in the landmark case of *Duhig v. Peavy-Moore Lumber Co.*,⁴⁶ Duhig owned the surface and one-half of the minerals with the other half outstanding in his grantor. By general warranty deed, he conveyed the entire surface and reserved a one-half mineral interest, without any mention of the outstanding interest of his grantor.⁴⁷ Duhig's deed thus evidenced an intent to reserve one-half of the minerals to Duhig and to convey to the grantee the other half. Given the one-half interest of Duhig's grantor, clearly both the grant and the reservation could not operate.⁴⁸ Relying on an analogy to the doctrine of after-acquired title,⁴⁹ the Supreme Court of Texas held that the grantee acquired title to the surface and an undivided one-half of the oil, gas, and other minerals.⁵⁰ Furthermore, Duhig was estopped from asserting title to an undivided one-half interest because to do so would breach the covenant of general warranty.⁵¹ The rule which emerged from this case has been formulated as follows:

[T]he grantor in a general warranty deed is estopped to claim title to an interest reserved therein when to permit him to do so would, in effect, breach his warranty with respect to the title and interest which the deed purports to convey.⁵²

3. Exceptions to the *Duhig* Rule

Although subjected to criticism⁵³ and limitations⁵⁴ during the past forty

46. 135 Tex. 503, 144 S.W.2d 878 (1940).

47. *Id.* at 505, 144 S.W.2d at 878.

48. See Meyers & Williams, *Oil and Gas Conveyancing: Royalty Reservations and Failure of Title*, 36 TEXAS L. REV. 399, 399 (1958). Meyers and Williams view the *Duhig* rule as merely an application of the general rule that in a warranty deed risk of failure falls on the grantor. See *id.* at 400; see also Discussion Notes, 2 OIL & GAS REP. (MB) 1359, 1359 (1953).

49. See *Duhig v. Peavy-Moore Lumber Co.*, 135 Tex. 503, 507, 144 S.W.2d 878, 880 (1940).

50. See *id.* at 508, 144 S.W.2d at 880.

51. See *id.* at 508, 144 S.W.2d at 880.

52. *Miles v. Martin*, 159 Tex. 336, 339, 321 S.W.2d 62, 65 (1959). For various statements of the rule, see *McMahon v. Christmann*, 157 Tex. 403, 408, 303 S.W.2d 341, 345 (1957); *Gibson v. Turner*, 156 Tex. 289, 298-99, 294 S.W.2d 781, 787 (1956); *Benge v. Scharbauer*, 152 Tex. 447, 452, 259 S.W.2d 166, 168 (1953); R. HEMINGWAY, *THE LAW OF OIL AND GAS* § 3.2, at 92 (1971); 5 F. LANGE, *LAND TITLES AND TITLE EXAMINATION* § 681, at 86-87 (Texas Practice 1961 & Supp. 1978); 1 H. WILLIAMS & C. MEYERS, *OIL AND GAS LAW* § 318, at 654-55 (1978); Barber, *Duhig To Date: Problems In The Conveyancing Of Fractional Mineral Interests*, 13 Sw. L.J. 320, 330 (1959).

53. See *McMahon v. Christmann*, 157 Tex. 403, 411, 303 S.W.2d 341, 346 (1957). The supreme court refers to the rule as "an arbitrary one at best," which should not be used to effect automatic transfers that would frustrate the parties' intentions. See *id.* at 411, 303

years, the *Duhig* doctrine has survived as a vital rule in the law of oil and gas conveyancing.⁵⁵ There are four areas of conveying fractional interests, however, to which the *Duhig* rule does not apply. The first such exception, illustrated by *Benge v. Scharbauer*,⁵⁶ is that while *Duhig* operates to reduce the grantor's interest, it may not effect his right to share in future lease benefits.⁵⁷ Scharbauer, who owned the surface and an undivided $\frac{3}{4}$ mineral interest, conveyed the surface to Benge with reservation to the grantor of an undivided $\frac{3}{8}$ interest in oil and gas and other minerals. Benge was given the right to execute leases, "but said leases shall provide for the payment of three-eighths ($\frac{3}{8}$ ths) of all the bonuses, rentals and royalties to the grantors."⁵⁸ Benge subsequently executed an oil and gas lease, and a dispute arose as to what benefits should be paid under the lease.⁵⁹ The deed had purported to convey a $\frac{5}{8}$ mineral interest and reserve a $\frac{3}{8}$ interest to the grantor. Applying *Duhig*, the court reduced the grantor's mineral interest to $\frac{1}{8}$ by subtracting the outstanding $\frac{1}{4}$ interest

S.W.2d at 346. One commentator is critical of the court's stating that the basis is estoppel when in actuality the rationale is breach of warranty. Estoppel, moreover, has no relation to breach of warranty. See Hemingway, *After-Acquired Title In Texas* (pt. 2), 20 Sw. L.J. 310, 321-22 (1966).

54. See Meyers & Williams, *Oil and Gas Conveyancing: Royalty Reservations and Failure of Title*, 36 TEXAS L. REV. 399, 400-01 (1958). See generally Hemingway, *After-Acquired Title In Texas* (pt. 2), 20 Sw. L.J. 310, 323-28 (1966).

55. Courtney, *Conveyancing And Assignments—Common Problems In The Transfer Of Oil, Gas And Other Mineral Interests*, STATE BAR OF TEXAS INSTITUTE—OIL AND GAS LAW FOR THE GENERAL PRACTITIONER B-1, B-9 (1980). The recurring nature of this fractional interest problem is evidenced by the number of cases in which the *Duhig* rule has been applied without modification. See *American Republics Corp. v. Houston Oil Co.*, 173 F.2d 728, 734-35 (5th Cir.), cert. denied, 338 U.S. 858 (1949); *McClung v. Lawrence*, 430 S.W.2d 179, 181 (Tex. 1968); *Bristow v. Selman*, 406 S.W.2d 896, 896 (Tex. 1966); *Sharp v. Fowler*, 151 Tex. 490, 494, 252 S.W.2d 153, 155 (1952); *Scarmardo v. Potter*, 613 S.W.2d 756, 758 (Tex. Civ. App.—Houston [14th Dist.] 1981, no writ); *Haddad v. Boon*, 609 S.W.2d 609, 615 (Tex. Civ. App.—Amarillo 1980, writ ref'd n.r.e.); *Jackson v. McKenney*, 602 S.W.2d 124, 126 (Tex. Civ. App.—Eastland 1980, writ ref'd n.r.e.); *Howell v. Liles*, 246 S.W.2d 260, 261 (Tex. Civ. App.—Amarillo 1951, no writ); *Fleming v. Miller*, 228 S.W.2d 355, 357 (Tex. Civ. App.—Eastland), rev'd in part on other grounds, 149 Tex. 368, 233 S.W.2d 571 (1950); Address by Jack Pope, Mineral Resources Section Meeting, Texas State Bar Convention, at 2-6 (July 1, 1981) (on file at St. Mary's Law Journal). The rule has also been adopted in other jurisdictions, although not necessarily by name. See *Brown v. Kirk*, 257 P.2d 1045, 1046-47 (Colo. 1953); *Continental Oil Co. v. Tate*, 30 So. 2d 858, 859 (La. 1947); *Salmen Brick & Lumber Co. v. Williams*, 50 So. 2d 130, 135 (Miss. 1951); *Murphy v. Athans*, 265 P.2d 461, 464 (Okla. 1953); *Ewing v. Trawick*, 256 P.2d 182, 186 (Okla. 1953).

56. 152 Tex. 447, 259 S.W.2d 166 (1953).

57. See Hemingway, *After-Acquired Title In Texas* (pt. 2), 20 Sw. L.J. 310, 323 (1966); Meyers & Williams, *Oil and Gas Conveyancing: Royalty Reservations and Failure of Title*, 36 TEXAS L. REV. 399, 400 (1958).

58. *Benge v. Scharbauer*, 152 Tex. 447, 452, 259 S.W.2d 166, 168 (1953).

59. See *id.* at 450, 259 S.W.2d at 167.

from the reservation, not the grant. Bengé, moreover, maintained that the bonuses and royalties should similarly be reduced.⁶⁰ Viewing the lease terms of royalty and bonus as a contractual agreement,⁶¹ however, the court refused to apply *Duhig* to reduce the grantor's proportionate share of the lease benefits.⁶² Rather, the warranty (and the *Duhig* rule) extended to what the deed purported to grant, but not to express provisions as to what royalties, bonuses, and rentals the grantor was to receive.⁶³

Secondly, *Duhig* does not apply to oil, gas, and mineral leases as opposed to deeds.⁶⁴ The rationale, as proposed in *McMahon v. Christmann*,⁶⁵ is that since deeds are usually prepared by grantors, *Duhig* properly places the risk of loss on the grantor; however, mineral leases are most often drawn up by the lessee.⁶⁶ In addition, the lessee often insists upon a lease which purports to convey the entire fee and then adequately protects himself by including a proportionate reduction clause.⁶⁷ If *Duhig* were applied, the lessee could receive all the lessor's fractional mineral interest without paying any royalty.⁶⁸

The grantee's actual knowledge of the outstanding interest provides a third exception to *Duhig*. In *Gibson v. Turner*,⁶⁹ decided a year prior to *McMahon*,⁷⁰ the owner of an undivided 9/40 in the minerals executed an

60. See *id.* at 453, 259 S.W.2d at 168.

61. See Barber, *Duhig To Date: Problems In The Conveyancing Of Fractional Mineral Interests*, 13 Sw. L.J. 320, 335 (1959).

62. *Benge v. Scharbauer*, 152 Tex. 447, 454-55, 259 S.W.2d 166, 169-70 (1953).

63. See *id.* at 453-54, 259 S.W.2d at 169.

64. See *McMahon v. Christmann*, 157 Tex. 403, 410, 303 S.W.2d 341, 346 (1957). See generally Barber, *Duhig To Date: Problems In The Conveyancing Of Fractional Mineral Interests*, 13 Sw. L.J. 320, 340 (1959); Lynch, *Effect Of Outstanding Mineral Or Royalty Interest On Conveyance Of Land Or Minerals*, SW. LEGAL FOUNDATION 21ST INST. ON OIL & GAS LAW & TAX. 141, 151 (1970); Meyers & Williams, *Oil and Gas Conveyancing: Royalty Reservations and Failure of Title*, 36 TEXAS L. REV. 399, 401 (1958); Discussion Notes 7 OIL & GAS REP. (MB) (1957).

65. 157 Tex. 403, 303 S.W.2d 341 (1957).

66. See *McMahon v. Christmann*, 157 Tex. 403, 410, 303 S.W.2d 341, 346 (1957). Professors Meyers and Williams suggest that *Duhig* should not apply to mineral title failure in oil and gas leases because the lessee is not bargaining for interest in the land. Instead he bargains for a leasehold title for which he pays a royalty as consideration. If the lessor conveys less than he purports, the remedy is that his consideration is reduced. Application of the *Duhig* doctrine, therefore, is not necessary. See Meyers & Williams, *Oil and Gas Conveyancing: Royalty Reservations and Failure of Title*, 36 TEXAS L. REV. 399, 426 (1958).

67. See *McMahon v. Christmann*, 157 Tex. 403, 410, 303 S.W.2d 341, 346 (1957).

68. See *id.* at 510, 303 S.W.2d at 346; Barber, *Duhig To Date: Problems In The Conveyancing Of Fractional Mineral Interests*, 13 Sw. L.J. 320, 340 (1959).

69. 156 Tex. 289, 294 S.W.2d 781 (1956).

70. The year after *Gibson* was decided the Texas Supreme Court held that *Duhig* was not applicable to oil and gas leases. See *McMahon v. Christmann*, 157 Tex. 403, 410, 303 S.W.2d 341, 346 (1957).

oil and gas lease which on its face appeared to cover 100% of the mineral estate, with a reservation of a $\frac{1}{8}$ royalty. The proportionate reduction clause had been crossed out. Moreover, the lessee knew the lessor only owned $\frac{9}{40}$ since the lessee held a lease on the other $\frac{31}{40}$.⁷¹ The rationale for this exception is that to apply *Duhig* would give the lessee something more than he bargained for;⁷² however, since this possibility exists in almost all *Duhig* cases, it is an exception that could virtually destroy the rule.⁷³ For that reason, courts seem to utilize this exception only when to apply *Duhig* would work a blatant injustice to one of the parties.⁷⁴

The fourth exception involves the effect of subsequent deed recitals on the application of the *Duhig* rule. *Pich v. Lankford*⁷⁵ is often cited for the proposition that a grantee who could have invoked *Duhig* is precluded from doing so if in a subsequent deed he recognizes both the outstanding interest his grantor failed to recite and the interest reserved to that grantor.⁷⁶ Clearly, the problem with such an exception is that the location of the title shifts, dependent on future events,⁷⁷ and leads to unsettled land titles.⁷⁸ This exception, however, is not a settled point of law; and courts seem reluctant to apply it,⁷⁹ as evidenced by the recent case of *Scarmardo v. Potter*.⁸⁰ Scarmardo, the grantee, in a subsequent conveyance recognized a $\frac{1}{8}$ interest reserved by his grantor Potter and a $\frac{1}{2}$ interest in Potter's grantor even though the Potter deed had made no mention of the outstanding $\frac{1}{2}$ interest.⁸¹ The court applied *Duhig*, giving Scarmardo Potter's $\frac{1}{8}$ interest, and rejected the *Pich v. Lankford* argument, distin-

71. See *Gibson v. Turner*, 156 Tex. 289, 298-99, 294 S.W.2d 781, 786 (1956); *Hemingway, After-Acquired Title In Texas* (pt. 2), 20 Sw. L.J. 310, 324 (1966).

72. See 1 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 311, at 578.34 (1978); SMITH, *Conveyancing Problems*, STATE BAR OF TEXAS PROFESSIONAL DEVELOPMENT PROGRAM—ADVANCED OIL, GAS AND MINERAL LAW COURSE G-1, G-20 (1981).

73. See Smith, *Conveyancing Problems*, STATE BAR OF TEXAS PROFESSIONAL DEVELOPMENT PROGRAM—ADVANCED OIL, GAS AND MINERAL LAW COURSE G-1, G-21.

74. See *id.* at G-20.

75. 295 S.W.2d 749 (Tex. Civ. App.—Amarillo 1956), *rev'd on other grounds*, 157 Tex. 335, 302 S.W.2d 645 (1957).

76. See 1 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 311.2, at 591 (1978); Smith, *Conveyancing Problems*, STATE BAR OF TEXAS PROFESSIONAL DEVELOPMENT PROGRAM—ADVANCED OIL, GAS AND MINERAL LAW COURSE G-1, G-11 (1981).

77. See 1 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 311.2, at 591 (1978). Justice Pope characterizes such a bouncing title depending on language in later deeds. See Address by Jack Pope, Mineral Resources Section Meeting, Texas State Bar Convention, at 4 (July 1, 1981) (on file at St. Mary's Law Journal).

78. See Smith, *Conveyancing Problems*, STATE BAR OF TEXAS PROFESSIONAL DEVELOPMENT PROGRAM—ADVANCED OIL, GAS AND MINERAL LAW COURSE G-1, G-12 (1981).

79. See *id.* at G-12.

80. 613 S.W.2d 756 (Tex. Civ. App.—Houston [14th Dist.] 1981, no writ).

81. See *id.* at 757.

guishing the cases on their facts.⁸² In a similar fact situation presented in *Jackson v. McKenney*,⁸³ the court rejected the argument that the subsequent recital created an interest in the grantor who failed to except the outstanding interest⁸⁴ by relying on the rule that a reservation or exception in favor of a stranger to the deed is inoperative.⁸⁵

A later deed which makes reference "for all purposes" to a prior deed negates the application of the *Duhig* rule even though the grantor fails to specifically except an outstanding interest.⁸⁶ The leading case supporting this exception is *Harris v. Windsor*.⁸⁷ Windsor, who owned an undivided $\frac{1}{2}$ mineral interest, conveyed a tract of land described by metes and bounds. The description was followed by the phrase "[a]nd being the same land described in Warranty deed from [Windsor's grantor] . . . reference to which is made for all purposes."⁸⁸ The deed then reserved an undivided $\frac{3}{8}$ mineral interest in the "above described premises."⁸⁹ The reference "for all purposes" has the legal effect of limiting the estate grantor intends to convey to the estate described in the prior deed and, thus, preventing a breach of warranty.⁹⁰ Windsor, therefore, received the $\frac{3}{8}$ interest and his grantor retained a $\frac{1}{2}$ interest.⁹¹

4. Drafting Suggestions

Once the *Duhig* rule and its exceptions are understood, problems with fractional mineral interests can be avoided by proper drafting. When drafting a conveyance for an owner of an undivided interest who intends to convey a fractional part of that undivided interest, the draftsman must be certain that that intention is stated directly and precisely in the granting clause. He cannot rely on clauses found elsewhere in the deed to limit the conveyance to a fraction of his interest.⁹² One possibility is to phrase

82. See *id.* at 759.

83. 602 S.W.2d 124 (Tex. Civ. App.—Eastland 1980, writ ref'd n.r.e.).

84. See *id.* at 126.

85. See *Canter v. Lindsey*, 575 S.W.2d 331, 335 (Tex. Civ. App.—El Paso 1978, writ ref'd n.r.e.); *Joiner v. Sullivan*, 260 S.W.2d 439, 440 (Tex. Civ. App.—Texarkana 1953, writ ref'd).

86. See Discussion Notes, 25 OIL & GAS REP. (MB) 109, 110 (1967).

87. 156 Tex. 324, 294 S.W.2d 798 (1956).

88. *Id.* at 326, 294 S.W.2d at 799.

89. *Id.* at 326, 294 S.W.2d at 799.

90. See *Harris v. Windsor*, 156 Tex. 324, 328-29, 294 S.W.2d 798, 801 (1956); see also Discussion Notes, 28 OIL & GAS REP. (MB) 663, 665-66 (1968). This exception to *Duhig* was applied in a recent case even though the reference to the prior conveyance did not include the phrase "for all purposes." See *Helms v. Guthrie*, 573 S.W.2d 855, 858 (Tex. Civ. App.—Forth Worth 1978, writ ref'd n.r.e.).

91. See *Harris v. Windsor*, 156 Tex. 324, 328-29, 294 S.W.2d 798, 801 (1956).

92. See Maxwell, *A Primer of Mineral and Royalty Conveyancing*, 3 U.C.L.A. L. Rev.

the grant as "one fourth interest of the five eighths interest"⁹³ Any reservation of an outstanding fractional interest must also be repeated in the warranty clause.⁹⁴ If the grantor is reserving an interest to himself in addition to the outstanding interest, the exception or reservation must be clearly expressed.⁹⁵ The following are suggested reservation clauses:

Grantor excepts herefrom such valid mineral and royalty interests in said land as may appear of record in the office of the Court Clerk of _____ County, Texas, and grantor further excepts herefrom and expressly reserves unto himself, his heirs, personal representatives, successors and assigns, an undivided _____ interest in the oil, gas and other minerals in and under and that may be produced from said land, it being understood and agreed that this interest shall be for the benefit of and be owned by the grantor, and his successors in interest and that in no event by warranty, estoppel, or otherwise, shall grantee or grantee's successors in interest acquire any part of said interest as a result of this conveyance.⁹⁶

OR

There is hereby reserved and excepted unto grantor, and not conveyed hereby, an undivided one-half of eight-eighths of all the oil, gas and other minerals in and under the physical land above described. There is also excepted and reserved herefrom, and not conveyed hereby, any and all interest in the minerals, and other interests in said physical land, record title to which is outstanding in anyone other than the grantor herein.⁹⁷

If there is a question about title and the owner wishes to reserve a fraction, the following provision can be used:

Grantor excepts and reserves for the exclusive benefit of grantor, his heirs and assigns, an undivided one-half mineral interest, this reservation and exception being in addition to any and all other interests in minerals, of parts thereof, including royalty interests, not owned by grantor, this deed conveying to the grantee only the surface estate and any mineral interest, if any, owned by grantor in and to the undivided one-half mineral interest not re-

449, 452-53 (1956).

93. *Id.* at 452; see *Spell v. Hanes*, 139 S.W.2d 229, 230 (Tex. Civ. App.—Texarkana 1940, writ dism'd judgment cor.).

94. See Maxwell, *A Primer of Mineral and Royalty Conveyancing*, 3 U.C.L.A. L. REV. 449, 453 (1956).

95. Discussion Notes, 2 OIL & GAS REP. (MB) 1359, 1360 (1953).

96. Courtney, *Conveyancing And Assignments—Common Problems In The Transfer Of Oil, Gas And Other Mineral Interests*, STATE BAR OF TEXAS INSTITUTE—OIL AND GAS LAW FOR THE GENERAL PRACTITIONER B-1, B-9 & 10 (1980).

97. Masterson, *Double Fraction Problems In Instruments Involving Mineral Interests*, 11 SW. L.J. 281, 289 (1957). The fraction should be computed on gross production (eight-eighths) to make the reservation clear. *Id.* at 289.

served and excepted hereby to the grantor, his heirs and assigns.⁹⁸

IV. ASSIGNMENTS

As Professor Merrill notes, the greater number of litigated oil and gas cases involve leases which have been assigned.⁹⁹ An oil and gas lease may be assigned either in whole or in part.¹⁰⁰ Upon assignment, the assignee assumes the same rights and obligations his assignor possessed at the time of assignment, unless there is a contrary provision.¹⁰¹ Similarly, the assignor remains liable to the lessor for breach of an express covenant¹⁰²

98. Discussion Notes, 2 OIL & GAS REP. (MB) 1359, 1360 (1953). If the grantor wishes only to convey the surface, he must expressly limit the grant to such in the granting clause. *See id.* at 1360.

99. *See* M. MERRILL, CONVENANTS IMPLIED IN OIL AND GAS LEASES 392-93 (2d ed. 1940). The high incidence of transfers is due to the speculative nature of oil and gas properties. *See* Warren, *Transfer of the Oil and Gas Lessee's Interest*, 34 TEXAS L. REV. 386, 386 (1956). For a typical assignment clause, *see* 6 F. ELLIOTT & R. HEMINGWAY, WEST'S TEXAS FORMS, § 3.3, at 97-98 (1977).

100. *See* 2 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 402, at 258 (1981). An assignment transfers the lessee's working interest under an oil and gas lease. *See id.* § 402, at 258. Whether Texas applies the traditional property law distinction between assignment and sublease to oil and gas leases is unclear. *See* Discussion Notes, 6 OIL & GAS REP. (MB) 368, 370 (1956). One commentator contends that Texas is the exception to the general rule that the reservation of an overriding royalty creates a sublease since the lessor's total interest is not transferred. *See* Brown, *Assignments Of Interests In Oil And Gas Leases, Farm-Out Agreements, Bottom Hole Letters, Reservations Of Overrides And Oil Payments*, SW. LEGAL FOUNDATION 5TH INST. ON OIL & GAS LAW & TAX. 25, 35 (1954). A federal court adopted this reasoning in *Moore v. Campbell*, 267 F. Supp. 126, 134 (N.D. Tex. 1967) (citing Brown and Summers). Other legal writers point to the only Texas case to make such a distinction, wherein the reservation of an override technically created a sublease. *See* Hamblen v. Placid Oil Co., 279 S.W.2d 127, 131 (Tex. Civ. App.—Waco 1955), *rev'd on other grounds sub nom.* *Mecom v. Hamblen*, 155 Tex. 494, 289 S.W.2d 553 (1956). Summers views the reversal by the Texas Supreme Court as evidence that the distinction does not apply to oil and gas leases in Texas. *See* 3 W. SUMMERS, THE LAW OF OIL AND GAS § 553, at 612 (1938). One writer points out that Summers is in error because the supreme court reversed on the ground that Hamblen had no standing and did not consider the issue of assignment or sublease; thus, the civil appeals opinion stands. *See* Emery, *Assignment Or Sublease: A Probable Consequence Of The Distinction*, 21 OKLA. L. REV. 133, 146-47 (1968); Discussion Notes, 5 OIL & GAS REP. (MB) 788, 788 (1956).

101. *See* *Simms Oil Co. v. Colquitt*, 2 S.W.2d 421, 422 (Tex. Comm'n App. 1928, *judgmt* adopted); *Pearson v. Black*, 120 S.W.2d 1075, 1079 (Tex. Civ. App.—Eastland 1938, *no writ*). A partial assignment can transfer an undivided working interest or rights to certain formations, minerals, or a specific portion of the land covered by the lease. *See* 2 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 404, at 271-72 (1981). Inclusion of an express provision as to payment of delay rentals is advisable in the case of partial assignments because partial payment of rental may not keep the lease alive during the primary term. *Cosden Oil Co. v. Scarborough*, 55 F.2d 634, 638 (5th Cir. 1932); *see also* 2 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 407.1, at 276.13-276.14 (1981).

102. *See, e.g.,* *Felmont Oil Corp. v. Pan Am. Petroleum Corp.*, 334 S.W.2d 449, 453

unless there is a clause relieving him of liability for a good faith assignment.¹⁰³

In the usual case, the assignor carves an interest out of the assignee's working interest,¹⁰⁴ generally either an overriding royalty¹⁰⁵ or an oil payment.¹⁰⁶ These interests are dependent upon the assignee's keeping the lease in force under the terms of the original lease either by paying delay rentals or producing.¹⁰⁷ Unless the instrument creating the overriding royalty contains a contrary provision, the interest continues or terminates

(Tex. Civ. App.—El Paso 1960, writ ref'd n.r.e.) (express and implied covenants run with land and are imposed on any taker of any part of lease); *Cox v. Sinclair Gulf Oil Co.*, 265 S.W. 196, 201 (Tex. Civ. App.—Austin 1924, writ ref'd) (assignees bound to perform covenants which affect lease as whole); *Pierce Fordyce Oil Ass'n v. Woodrum*, 188 S.W. 245, 248 (Tex. Civ. App.—Fort Worth 1916, no writ) (assignee who accepts assignment receives benefits and burdens of covenants running with land). Both the assignor and the assignee are liable for breaches, but the assignee bears the ultimate responsibility; thus, the assignor could receive reimbursement from the assignee for damages for a breach. See 2 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 403.4, at 271 (1981). Texas courts have held that even where there is no express agreement in the assignment, an implied covenant to protect against drainage exists where an overriding royalty is reserved. See, e.g., *Phillips Petroleum Co. v. Taylor*, 115 F.2d 726, 727 (5th Cir. 1940) (applying Texas law) (lessee in Texas impliedly covenants to drill offset wells), *rehearing denied*, 116 F.2d 994 (5th Cir.), *cert. denied*, 313 U.S. 565 (1941); *Bolton v. Coats*, 533 S.W.2d 914, 916 (Tex. 1975) (assignee impliedly covenants to protect premises against drainage); *Wes-Tex Land Co. v. Simmons*, 566 S.W.2d 719, 721 (Tex. Civ. App.—Eastland 1978, writ ref'd n.r.e.) (prudent operator would have drilled offset well to ensure production in paying quantities).

103. One such clause is as follows: "An assignment of this lease, in whole or in part, shall, to the extent of such assignment, relieve and discharge lessee of any obligations hereunder." *Hafeman v. Gem Oil Co.*, 80 N.W.2d 139, 155 (Neb. 1956).

104. See H. WILLIAMS & C. MEYERS, MANUAL OF OIL AND GAS TERMS 838 (5th ed. 1981).

105. See *MacDonald v. Follett*, 142 Tex. 616, 619, 180 S.W.2d 334, 336 (1944). An overriding royalty is an interest reserved from the working interest or the lessee's share of the oil, free from production costs. See H. WILLIAMS & C. MEYERS, MANUAL OF OIL AND GAS TERMS 518 (5th ed. 1981). In Texas an overriding interest is a conveyance of real estate. See *Colquitt v. Eureka Producing Co.*, 63 S.W.2d 1018, 1021 (Tex. Comm'n App. 1933, judgment adopted), *reh. overruled*, 67 S.W.2d 224 (Tex. Comm'n App. 1934). See generally Brown, *Assignments Of Interests In Oil And Gas Leases, Farm-Out Agreements, Bottom Hole Letters, Reservations Of Overrides And Oil Payments*, SW. LEGAL FOUNDATION 5TH INST. ON OIL & GAS LAW & TAX. 25, 50-59 (1954).

106. See, e.g., *Standard Oil Co. v. Marshall*, 265 F.2d 46, 53 (5th Cir.), *cert. denied*, 361 U.S. 915 (1959); *Tennant v. Dunn*, 130 Tex. 285, 290, 110 S.W.2d 53, 56 (1937); *Alamo Nat'l Bank v. Hurd*, 485 S.W.2d 335, 340 (Tex. Civ. App.—San Antonio 1972, writ ref'd n.r.e.). An oil payment is a gross share of the oil produced from a lease, terminating when a certain amount has been realized from the sale of such oil. See H. WILLIAMS & C. MEYERS, MANUAL OF OIL AND GAS TERMS 493 (5th ed. 1981).

107. See *id.* at 519 (5th ed. 1981). Unless an express provision is present, termination of the lease means termination of the override. See *Rogers Nat'l Bank v. Pewitt*, 231 S.W.2d 487, 489 (Tex. Civ. App.—Texarkana 1950, writ ref'd).

with the leasehold estate from which it is carved.¹⁰⁸ In order to protect the override or oil payment, it is now common to include a reassignment clause in the assignment agreement.¹⁰⁹ In general, the clause requires the assignee to give his assignor advance notice if he intends to allow the lease to lapse, enabling the assignor to continue the lease himself.¹¹⁰ Since there is no standard form or interpretation given to the provision by the courts,¹¹¹ drafting the reassignment clause is extremely important for the purpose of tailoring the clause to fit the needs or desires of the parties.

There are several situations that arise in which the language employed in the reassignment provision is especially crucial. The first problem area is the choice of words as to what conditions will invoke the operation of the reassignment clause. Usually, intent to surrender the lease requires assignee to notify the assignor.¹¹² One question which arises is whether the assignee is liable for damages to the assignor under the reassignment clause when he unintentionally allows the lease to lapse.¹¹³

108. See, e.g., *Keese v. Continental Pipeline Co.*, 235 F.2d 386, 388 (5th Cir. 1956) (overriding royalty interest cannot survive termination of leasehold estate); *MacDonald v. Follett*, 142 Tex. 616, 618-19, 180 S.W.2d 334, 336-37 (1944) (defendant wanted renewals executed to continue overriding royalties in force); *Harrison v. Barngrover*, 72 S.W.2d 971, 973-74 (Tex. Civ. App.—Beaumont 1934, no writ) (lease by guardian expires when minor reaches majority; royalty payments also cease).

109. See 2 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 428.2, at 472 (1981). The reassignment clause is particularly important in light of the fact that the assignee owes the assignor no fiduciary duty. See *Montgomery v. Phillips Petroleum Co.*, 49 S.W.2d 967, 973 (Tex. Civ. App.—Amarillo 1932, writ ref'd). The purpose of the clause is to protect the override against premature termination of the lease, but it does not have the effect of imposing a duty on the assignee to pay the rentals or otherwise extend the lease. Rather, it imposes a duty to notify the assignor if he intends not to extend the lease. See *Eaton, The Reassignment Provision—Meaningful Or Not?*, ROCKY MT. 20TH ANN. MINERAL LAW INST. 601, 601 (1975).

110. See H. WILLIAMS & C. MEYERS, MANUAL OF OIL AND GAS TERMS 621 (5th ed. 1981). The following is an example of such a clause:

Assignee shall always have the right to release and surrender the lease hereby assigned, provided that before releasing or surrendering, and at least 60 days prior to the next rental due date, he shall first notify assignor in writing of his intention so to do, and upon demand by assignor, if made within 30 days from the receipt of such notice, assignee shall reassign to assignor the rights and interests which he has indicated in his notice that he desires to release or surrender.

McLaughlin v. Ball, 431 S.W.2d 305, 305-06 (Tex. 1968). The reassignment provision is a covenant running with the land. In other words, the reassignment clause in a lease from A to B is binding on B's assignee. See *Gould v. Schlachter*, 443 S.W.2d 764, 765 (Tex. Civ. App.—Eastland 1969, no writ).

111. See *Eaton, The Reassignment Provision—Meaningful Or Not?*, ROCKY MT. 20TH ANN. MINERAL LAW INST. 601, 601 (1975).

112. See *id.* at 604-05.

113. See *id.* at 614. The usual measure of damages for failure to notify when required by a reassignment clause to do so is the value of the leasehold estate at the time the lease

In *Walton v. Atlantic Richfield Co.*,¹¹⁴ the Wyoming Supreme Court literally construed the terms "desire to surrender" so that a mistake which caused the lease to terminate rendered the reassignment clause inapplicable.¹¹⁵ Since the assignee had not "desired" to surrender the lease, he could not be held liable.¹¹⁶ Thus, if the assignor desires damages for loss of the lease, even if by mistake, he should clearly state such in the reassignment clause.¹¹⁷

The second important area to consider is whether the reassignment provision extends beyond the primary term. In *King v. Swanson*,¹¹⁸ an oil payment contract provided that before surrender of the lease during the primary term the assignee would give the assignor sixty days notice.¹¹⁹ Two and a half years after the primary term expired, the assignee offered a release to the landowners of the leased tract without first offering it to his assignor Swanson.¹²⁰ Swanson then sued for damages for breach of the reassignment provision.¹²¹ Rejecting Swanson's claim, the court defined "primary term" as meaning the period of time an oil and gas lease could be kept in force without production by the payment of delay rentals. The assignee, therefore, had no duty under the reassignment clause after the primary term had expired.¹²² Nonetheless, the reassignment clause has no

terminates. See, e.g., *McLaughlin v. Ball*, 431 S.W.2d 305, 306 (Tex. 1968); *Matthewson v. Fluhman*, 41 S.W.2d 204, 207 (Tex. Comm'n App. 1931, judgment adopted); *Gladys Belle Oil Co. v. Turner*, 12 S.W.2d 847, 849 (Tex. Civ. App.—Austin 1929, writ ref'd). Damages can be limited by the reassignment clause itself. A typical example is as follows: "Assignee's liability for breach of the agreement contained in this paragraph shall be limited to the cash consideration paid for this assignment." Eaton, *The Reassignment Provision—Meaningful Or Not?*, ROCKY MT. 20TH ANN. MINERAL LAW INST. 601, 617-18 (1975). If the assignee has reassigned without notifying the assignor, thus breaching the reassignment clause, the court may impose a constructive trust on the new lease to satisfy the override or payment due the assignor. See *Thomas v. Warner-Quinlan Co.*, 65 S.W.2d 321, 325 (Tex. Civ. App.—Eastland 1933, writ ref'd) (but no constructive trust allowed because no breach of reassignment covenant); 2 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 428.2, at 475 (1981).

114. 501 P.2d 802 (Wyo. 1972).

115. See *id.* at 802-03.

116. See *id.* at 804. Another example of strict construction of a reassignment clause is found in *Phillips v. Inexco Oil Co.*, 540 S.W.2d 546, 549 (Tex. Civ. App.—Tyler 1976, writ ref'd n.r.e.). The reassignment clause provided that if the well were plugged or abandoned or if assignee determined to surrender the lease, he should give written notice. See *id.* at 547. Since the well was producing, it was never plugged or abandoned; therefore, the clause did not operate. See *id.* at 549.

117. See Eaton, *The Reassignment Provision—Meaningful Or Not?*, ROCKY MT. 20TH ANN. MINERAL LAW INST. 601, 608 (1975).

118. 291 S.W.2d 773 (Tex. Civ. App.—Eastland 1956, no writ).

119. See *id.* at 776.

120. See *id.* at 776.

121. See *id.* at 774.

122. See *id.* at 776. Since the purpose of the clause is to protect against the premature

set form and can be drafted to extend the clause into the secondary term.¹²³

The following are suggested guidelines for consideration when drafting a lease assignment: (1) add a reassignment clause if a non-operating interest is being retained;¹²⁴ (2) extend the obligation to intended or unintended surrender¹²⁵ of the lease prior to the end of the primary term or secondary term if so desired;¹²⁶ (3) set the damages for breach as the value of the reserved interest;¹²⁷ (4) red flag lease records to indicate a reassignment provision.¹²⁸

V. TOP LEASING

A top lease is a lease executed on land already under a valid existing mineral lease, which becomes effective when the current, or bottom,¹²⁹ lease terminates.¹³⁰ Top leases are of two types: (1) two party, where lessee and lessor of the top lease are the same as those of the bottom lease; and (2) third party, where original lessor executes a top lease to a third party.¹³¹ Prior to the 1970's, top leasing, characterized by one court as akin to claim jumping,¹³² was considered illegal or immoral because of the industry custom that the original lessee has a preferential right to renew its lease without undue interference from the competition.¹³³ The dwindling domestic oil and gas reserves and the resultant energy crisis and need for more exploration have heightened the competition for oil and gas leases and have, thus, fostered an increasing acceptance of the

loss of the override, there is no reason to extend it past the primary term into the "thereafter" term. See Eaton, *The Reassignment Provision—Meaningful Or Not?*, ROCKY MT. 20TH ANN. MINERAL LAW INST. 601, 611 (1975).

123. See Eaton, *The Reassignment Provision—Meaningful Or Not?*, ROCKY MT. 20TH ANN. MINERAL LAW INST. 601, 611 (1975).

124. See *Keese v. Continental Pipe Line Co.*, 235 F.2d 386 (5th Cir. 1956).

125. See *Walton v. Atlantic Richfield Co.*, 501 P.2d 802 (Wyo. 1972).

126. See *King v. Swanson*, 291 S.W.2d 773 (Tex. Civ. App.—Eastland 1956, no writ).

127. See *McLaughlin v. Ball*, 431 S.W.2d 305 (Tex. 1968).

128. See Eaton, *The Reassignment Provision—Meaningful Or Not?*, ROCKY MT. 20TH ANN. MINERAL LAW INST. 601, 623 (1975).

129. See Ernest, *Top Leasing—Legality v. Morality*, ROCKY MT. 26TH ANN. MINERAL LAW INST. 957, 957 (1980).

130. See *Frankford Oil Co. v. Snakard*, 279 F.2d 436, 445 n.23 (10th Cir.), cert. denied, 364 U.S. 920 (1960).

131. See Ernest, *Top Leasing—Legality v. Morality*, ROCKY MT. 26TH ANN. MINERAL LAW INST. 957, 958 (1980).

132. See *Frankford Oil Co. v. Snakard*, 279 F.2d 436, 445 n.23 (10th Cir.), cert. denied, 364 U.S. 920 (1960).

133. See Ernest, *Top Leasing—Legality v. Morality*, ROCKY MT. 26TH ANN. MINERAL LAW INST. 957, 980 (1980).

practice of top leasing.¹³⁴

Part of the controversy over top leasing centers around the doctrine of obstruction, which holds that a lessor who unequivocally interferes with the lessee's ability to comply with lease terms cannot then claim that the lease is terminated because the lessee cannot reasonably be expected to continue exploration or production.¹³⁵ In *Simons v. McDaniel*¹³⁶ the very existence of a top lease was held to be an obstruction of the bottom lessee's title in that it declared the existing lease at an end.¹³⁷ Texas courts, however, have implicitly recognized top leasing as a valid practice and have not treated the mere existence of a top lease as an issue of obstruction.¹³⁸ Top leasing coupled with other hostile acts on the part of the lessor, however, may constitute obstruction.¹³⁹

134. See Brown, *Effect Of Top Leases: Obstruction Of Title And Related Considerations*, 30 BAYLOR L. REV. 213, 243 (1978). One commentator suggests that top leasing has become such a common practice that it is now merely a business decision rather than an ethical question. See Ernest, *Top Leasing—Legality v. Morality*, ROCKY MT. 26TH ANN. MINERAL LAW INST. 957, 984 (1980). While very little top leasing occurs in West Texas, independents frequently top lease for major oil companies in East Texas; and in Oklahoma it has become a "a way of life." *Id.* at 969. Case law on the subject of top leasing, however, is minimal in Texas.

135. See *Kothman v. Boley*, 158 Tex. 56, 60, 308 S.W.2d 1, 4 (1957); 2 E. KUNTZ, A TREATISE ON THE LAW OF OIL AND GAS § 26.14 at 324-25 (1964). In *Kothman*, the court held that the notice of termination of the lease must be unqualified if lessee is to be estopped from complaining of lessor's suspension of operations pending determination of the controversy. If the court determines the action was an obstruction, lessee receives an extension on the lease equal to the amount of time which remained to lessor under the lease when the obstruction occurred. See *Kothman v. Boley*, 158 Tex. 56, 60, 308 S.W.2d 1, 4 (1957).

136. 7 P.2d 419 (Okla. 1932).

137. *Id.* at 420; accord *Robinson v. Continental Oil Co.*, 255 F. Supp. 61, 63 (D. Kan. 1966) (top lease was a cloud on title which excused tender of shut-in royalty payments). *Contra Rorex v. Karcher*, 224 P. 696, 697 (Okla. 1923) (top lease valid so long as taken subject to bottom lessee's rights).

138. See, e.g., *Obelgoner v. Obelgoner*, 526 S.W.2d 790, 791-92 (Tex. Civ. App.—Corpus Christi 1975, writ ref'd n.r.e.) (primary term of top lease begins on date of execution rather than expiration of prior oil and gas lease); *Nafco Oil & Gas, Inc. v. Tartan Resources Corp.*, 522 S.W.2d 703, 709-10 (Tex. Civ. App.—Corpus Christi 1975, writ ref'd n.r.e.) (top lessees prevailed over bottom lessees by showing production had ceased under terms of bottom lease); *Ellison v. Butler*, 443 S.W.2d 886, 887 (Tex. Civ. App.—Corpus Christi 1969, no writ) (top lessee failed to show that bottom lessee had violated any terms of his lease).

139. See *Shell Oil Co. v. Goodroe*, 197 S.W.2d 395, 400 (Tex. Civ. App.—Texarkana 1946, writ ref'd n.r.e.) (executing a top lease and repudiating and demanding surrender of prior lease while still in effect equals obstruction). The lessor's aggregate conduct will be considered to determine if obstruction occurred. See Brown, *Effect Of Top Leases: Obstruction Of Title And Related Considerations*, 30 BAYLOR L. REV. 213, 230 (1978). One commentator suggests that the question of a top lease being an obstruction should turn on whether the bottom lessee had knowledge of the top lease and could reasonably be expected to deter his operations in reliance thereon. See 5 E. KUNTZ, A TREATISE ON THE LAW OF OIL AND GAS § 56.2, at 40 (1978). One Texas court of civil appeals adopted this reasoning. See *Atlan-*

In drafting a top lease, the document should recite that the top lease takes effect subject to the existing rights, if any, under the bottom lease in order to avoid a cloud on the title.¹⁴⁰ The use of the qualifying phrase "if any" is important in order to avoid the possibility of ratifying or reviving an expired lease by the execution of a top lease.¹⁴¹ A top lease should be dated the day of execution and then promptly recorded.¹⁴² A lessee may avoid being top leased by including in the lease a clause which requires notice to the lessee of any offer to top lease and gives him an option to purchase the lease on the same terms.¹⁴³ A lessee who has already been top leased must begin drilling operations and establish production before the end of the primary term in order to protect his lease.¹⁴⁴ If unable to achieve production, an alternative for the bottom lessee is to enter a pooling agreement with owners of producing acreage.¹⁴⁵ As top leasing becomes a more widespread practice, attorneys must be prepared to advise clients holding oil and gas interests of their rights and liabilities under such leases.

VI. CONCLUSION

The majority of litigation involving oil and gas conveyances could be

tic Richfield Co. v. Hilton, 437 S.W.2d 347, 355 (Tex. Civ. App.—Tyler, writ ref'd n.r.e.) (bottom lessee admitted no knowledge of top lease prior to primary term expiration), cert. denied, 396 U.S. 905 (1969).

140. See Brown, *Effect Of Top Leases: Obstruction of Title And Related Considerations*, 30 BAYLOR L. REV. 213, 227 (1978). If *Simons* is the correct rule, such conditional language will not necessarily prevent top leasing from being considered an obstruction. See *id.* at 227-28. For suggested forms for top leases, see Ernest, *Top Leasing—Legality v. Morality*, ROCKY MT. 26TH ANN. MINERAL LAW INST. 957, 972-77 (1980).

141. See Brown, *Effect Of Top Leases: Obstruction Of Title And Related Considerations*, 30 BAYLOR L. REV. 213, 227 n.121 (1978).

142. See Ernest, *Top Leasing—Legality v. Morality*, ROCKY MT. 26TH ANN. MINERAL LAW INST. 957, 978 (1980).

143. The following is an example of such a clause:

In the event the lessor, during the primary term of this lease, receives a bona fide offer which lessor is willing to accept from any party offering to purchase from lessors a lease covering any or all of the substances covered by this lease and covering all or a portion of the land described herein, with the lease becoming effective upon expiration of this lease, lessor hereby agrees to notify lessee in writing of said offer immediately, including in the notice the name and address of the offeror, the price offered and all other pertinent terms and conditions of the offer. Lessee, for a period of fifteen days after receipt of the notice, shall have the prior and preferred right and option to purchase the lease or part thereof or interest therein, covered by the offer at the price and according to the terms and conditions specified in the offer.

Id. at 979.

144. See *id.* at 982.

145. See *id.* at 982.

avoided by precise drafting.¹⁴⁶ Generally, the draftsman of an oil and gas conveyance should observe the following guidelines:

- (1) At the outset before any drafting is begun, determine the exact nature and extent of the grantor's interest, whether it be a full fee simple or a fractional interest.
- (2) Obtain a full understanding of what the parties intend to sell, assign, reserve, or receive.
- (3) Express those intentions in as clear and straight forward language as possible, defining clearly any terms, phrases, or conditions that could be read ambiguously.
- (4) Specifically except any outstanding interests by a clause inserted in the conveyance.
- (5) In reviewing the document, checklist the common problem areas of conveyancing to ensure that they have been avoided.

This comment has attempted to "red flag" some of these areas of difficulty and offer suggested language so as to avoid confusion or dispute over what rights and interests are created by an oil and gas conveyance. In an era of increasing transactions in oil and gas interests, careful drafting and a knowledge of certain construction problems is essential if the attorney is to assist his client effectively.

146. As one commentator phrases it, however, "as long as poorly written conveyances are prepared by draftsmen who do not carefully consider the effect of what they are drafting upon the property interests with which they are dealing, there will be work for lawyers." Harrell, *Recent Developments In Non-regulatory Oil And Gas Law*, SW. LEGAL FOUNDATION 31ST INST. ON OIL & GAS LAW & TAX. 327, 362 (1980).