Presented to

Central States Law School Association

30 April 1988

Rock Lane Lodge Branson, Missouri

by

David E. Pierce

Associate Professor of Law Tulsa University College of Law

Associate Director National Energy Law & Policy Institute

> Of Counsel Gable & Gotwals Tulsa, Oklahoma

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I. OIL AND GAS AND FUNDING FOR EDUCATION

MINERAL TAXES

Arkansas

Production*

•

Gas		3/10 of \$.01/thousand cubic feet (MCF)
Oil		5% of market value	
	Ark.	Stat. Ann. § 26-58-111 (1987)	

Distribution

3.000%	General Revenue Fund
72.075%	State Treasury
12.125%	County Highway Fund
12.125%	County Public School Fund
Ark.	Stat. Ann. § 26-58-124 (1987)

Ad Valorem

Severed m	aineral	inte	res	sts.	
Ark.	Stat.	Ann.	§	26-26-1110	(1987)

Iowa

Ad Valorem

Severed mineral interests. Iowa Code Ann. § 259.220 (West 1984).

Kansas

Production

Gas		8% gross	s valu	ue		
Oil		8% gross	s valu	ue		
	Kan.	Stat. A	nn. §	79-4217	(Supp.	1987)

Distribution

93.00%	State General Fund
3.50%	County General Fund (where wells located)
3.50%	School Districts (county where wells located)
Kan.	Stat. Ann. § 79-4227 (Supp. 1987)

*All figures indicate the maximum rate. States with severance taxes have lower rate for marginal ("stripper") wells.

Kansas, continued

Ad Valorem

Severed mineral interests. Kan. Stat. Ann. § 79-1439 (1984)

Value based upon value of production. Kan. Stat. Ann. §§ 79-329 & 79-331 (1984)

Credits

3.67% value of oil produced and taxed 1.00% value of gas produced and taxed Kan. Stat. Ann. § 79-4219 (1984)

Minnesota

Ad Valorem

Severed mineral interests. Minn. Stat. Ann. § 272.04 (West Supp. 1988)

Missouri

Ad Valorem

Severed mineral interests. Mo. Ann. Stat. § 259.220 (Vernon Supp. 1988)

Nebraska

Production

Gas 3% gross value Oil 3% gross value Neb. Rev. Stat. § 57-703 (1984)

Distribution

1.00% State Treasurer (for administering the tax)
First \$500,000 - Nebraska Energy Resource Fund
Balance - School Weatherization Fund
Neb. Rev. Stat. \$ 57-705 (Supp. 1986)

Ad Valorem

Severed mineral interests & other mineral interests. Neb. Rev. Stat. § 77-103 (1986) Oklahoma

Production

Gas 7% market value Oil 7% market value Okla. Stat. tit. 68, § 1001 (Supp. 1987) 12.5% market value of oil recovered from streams, lakes, ponds, and other natural depressions. Okla. Stat. tit. 68, § 1003 (1981) Distribution 011 80% General Revenue Fund 10% County Highway Fund 10% School Districts 02% General Revenue Fund Gas 10% County Highway Fund 10% School Districts 78% State Treasurer to divide as follows: First \$125,000,000 Teachers' Retirement Balance - Pension Systems Reserve Fund Okla. Stat. tit. 68, § 1004 (Supp. 1987)

Ad Valorem

Severed mineral interests & other mineral interests. Okla. Stat. tit. 68, §§ 2419 & 2420 (1981)

<u>Excise</u>

Gas		085 0	f \$. 01	l ma	rket	: valu	ıe		
011	•	21875	of \$.	.01	per	barre	21		
	Okla.	Stat.	tit.	68,	- §§	1101	&	1102	(1981)

Distribution

Oil & Gas Conservation Fund Okla. Stat. tit. 68, § 1103 (1981)

IMPACT OF PRICE AND VOLUME ON TAX REVENUES

Kansas Statistics -

1979	Gas	Pro	đuo	ction				804,500,000	MCF
1983	Gas	Pro	đuo	ction				438,500,000	MCF
1987	Gas	Pro	duo	ction				459,000,000	MCF
1979	0i 1	Pro	duo	ction				57,000,000	Barrels
1983	Oil	Pro	duc	ction				72,000,000	Barrels
1987	Oil	Pro	đuo	ction				59,500,000	Barrels
[1956	5 01	l Pro	odu	ictio	n			340,000,000	Barrels]
Price	e of	0i 1	_	1979	_	\$30	to	\$35/Barrel	
Price	e of	0il	-	1987	-	\$12	to	\$18/Barrel	

Price of Gas (Effect of long term contracts and regulation have kept Kansas gas prices fairly constant, and relatively low (\$0.30 to \$0.60/MCF for a major portion of Kansas gas reserves). New regulatory efforts to "de-regulate" the gas market will tend to actually raise the net gas tax revenue overall for Kansas. Prices will gradually rise to current market levels (\$1.15 to \$1.50 as of 26 April 1988).

Ad	Valorem	Assessment	Value	Fluctuations:	
	-				

7 January 1986	\$25.00/Barrel
3 March 1986	18.00/Barrel
Producer Value Figur	e 14.00/Barrel

Severance Tax Collections:

FY	1984	\$106.1	Million
FY	1985	101.3	Million
FY	1986	92.0	Million
FY	1987	57.1	Million

IMPACT OF PRICE ON MARGINAL RESERVES

Price	Stripper Wells Lost	Reserves Lost
\$25	No Effect on Existing	45,749 Stripper Wells
\$15	10,307	29,112 Barrels/Day 77,098,000 Total
\$ 10	18,656	67,037 Barrels/Day 274,311,000 Total
\$1.00 dec:	rease in crude oil price	= \$8.1 Million Tax Decrease

Source of Figures: RAM Group, Ltd., Oklahoma City Interstate Oil Compact Commission

- II. OIL AND GAS LAW AS A VEHICLE FOR INTERDISCIPLINARY STUDY
 - A. Regulation of a Resource and Related Industries
 - 1. Opportunity for interdisciplinary study of law.
 - 2. Oil and gas law is designed to:
 - a. Allocate rights in the oil and gas resource.
 - b. Control the exploration, development, production, and transfer of the oil and gas resource.
 - 3. The allocation process encompasses property law, contract law, and other disciplines which affect ownership of property rights - such as estates & trusts, family law, creditor/debtor law.
 - 4. The development process triggers a range of problems which must be addressed in the context of other legal disciplines.

EXAMPLE:

Acme Oil Co. has the right to develop the oil and gas in Section 30. However, Acme refuses to assume all the risk required to test (by drilling a deep hole in the ground) Section 30 for commerical deposits of oil and gas.

Acme decides to share the risk with Doctors <u>A</u>, <u>B</u>, and <u>C</u>. Each of the doctors pay Acme \$50,000 for an undivided 1/4th interest in Acme's Section 30 development rights. Assuming it costs \$100,000 to drill and complete a well on Section 30, Acme has leveraged (promoted) his investment with <u>A</u>, <u>B</u>, and <u>C</u>. Acme will probably make money even if the well is a dry hole.

Suppose Acme leaves town, with the doctors' money, without paying the contractor who drilled the well? Are <u>A</u>, <u>B</u>, and <u>C</u> liable for the unpaid bill under the drilling contract between Acme and the drilling contractor? Suppose one of the drilling contractor's employees is injured while drilling the well. Can the doctors and Acme be held responsible for the employee's injuries?

Suppose Acme doesn't leave town but files for bankruptcy? Suppose the well is improperly plugged and causes ground water pollution? Can the doctors, Acme, the trustee in bankruptcy (or debtor in possession), or a foreclosing bank be held responsible for the pollution?

Doctors <u>A</u>, <u>B</u>, and <u>C</u> claimed certain losses on their 1987 income tax return relating to their oil and gas investment with Acme. Do expenses relating to the drilling of the well on Section 30 qualify as "passive" losses which can only be used to offset passive gains?

- 5. In this rather simple example a number of legal disciplines must be examined to determine the rights of the parties:
 - a. Property and Contract Law. To identify the respective rights of the parties under various conveyances and contractual relationships.
 - b. Securities Regulation. To protect the interests of the investing public (Doctors \underline{A} , \underline{B} , and \underline{C}).
 - c. Agency and Partnership Law. To determine the legal relationships between Acme and <u>A</u>, <u>B</u>, and <u>C</u>, and their relationships to third parties.
 - d. Tort Law. To determine whether Acme or others may be liable for injuries suffered by the drilling contractor.

Also need to incorporate contract law since the drilling usually occurs pursuant to a drilling contract between the developer (Acme) and the drilling contractor. Typical to have indemnity provisions in the contract which leverage risk between the parties. This may raise public policy issues; in some states (Louisiana, New Mexico, Texas, Wyoming) statutes provide such indemnity provisions are against public policy and unenforceable.

e. Article 9 UCC; Mortgage Law; Bankruptcy Code. Oil and gas development is a high risk business. Not only is it dangerous, it is capital intensive. Chances are (90%) exploratory drilling will result in a dry hole. Nothing to salvage from the venture usually the major potential asset, a deep hole in the ground, is a liability because you have to spend money to plug it properly.

- f. Environmental Law. Oil and gas development creates a number of potential environmental hazards. Liability is becoming more of a reality; this will affect all phases of the development process.
- g. Tax Law. Since the oil and gas business is a capital-intensive industry, the industry must compete for private investment capital from individuals willing to take a much higher degree of risk for a potentially higher rate of return on their investment. Capital has traditionally been attracted through various tax incentives which permit accelerated deductions for investment dollars.

Many common oil and gas transactions are structured to achieve a positive tax benefit or avoid adverse tax consequences.

- B. Administration of the Oil and Gas Property Interest
 - 1. Recent developments in oil and gas law demonstrate that all attorneys practicing in states where oil and gas are found require some basic knowledge concerning the ownership, development, and sale of oil and gas.
 - 2. Oil and gas, as a property interest, will be transferred by voluntary and involuntary means like other types of property. A sale of real estate will require consideration of oil and gas issues. Involuntary transfers, such as death or judicial action (e.g. divorce, foreclosure, quiet title, partition, condemnation, bankruptcy), requires an understanding of oil and gas law to ensure the transfer is properly completed.
 - 3. Oil and gas property interest has proven difficult to administer.
 - a. Complex ownership and development relationships.
 - b. Potential value of the property interest assures a dispute for any sort of irregularity.
 - Cannot rely upon good property law or contract law logic to resolve oil and gas disputes.
 Oil and gas law is a hybrid body

of law which draws upon many different legal disciplines - but seldom transplants concepts without revision.

- d. In many states, oil and gas law is the area of practice with the highest incidence of malpractice claims - and successful recoveries.
- 4. Goal of my presentation is to provide persons who teach in other disciplines an opportunity to learn about oil and gas law and how oil and gas law may impact your areas of interest.
- III. THE LAW AND THE PHYSICAL WORLD IT ATTEMPTS TO ORDER -THE OIL AND GAS RESOURCE
 - A. Petroleum Geology.
 - 1. Organic theory of petroleum ("oil and gas") formation - through geologic time marine life died and accumulated with eroded sediment at the bottom of ancient oceans. Heat, pressure, and other processes converted the accumulated organic material into petroleum.
 - a. Source rock shale rocks where the conversion took place.
 - b. Reservoir rock porous and permeable rock which contains petroleum squeezed from the source rock.
 - 2. Search for petroleum includes theorizing where source rock would be and then looking for reservoir rock which might have trapped petroleum squeezed from the source rock.
 - 3. Petroleum normally found in sedimentary rock which possesses the physical properties of porosity and permeability.
 - a. Porosity the rock has spaces in which oil, gas, and water can accumulate.
 - b. Permeability the rock spaces are connected so the material within the spaces can be transmitted from pore to pore.
 - 4. A connected bed of porous and permeable rock which contains petroleum is called a "reservoir."

- a. The reservoir must be contained within natural barriers to "trap" the petroleum.
- b. Common types of trapping mechanisms:
 - (1) Anticline
 - (2) Fault
 - (3) Stratigraphic
 - (4) Syncline
- B. Reservoir Mechanics.
 - 1. The reservoir, in its natural state, is under pressure.
 - a. Once the reservoir is breached, the oil, gas, and water will move toward the low pressure zone created by the well.
 - b. Oil is produced through a displacement process. The oil will move toward the low pressure zone created by the well bore. Gas or water will move in to fill the pore space previously occupied by oil.
 - 2. Three types of reservoir drive mechanisms:
 - a. Dissolved Gas Expansion (Solution Gas Drive).
 - (1) As reservoir pressure is reduced by the well, gas dissolved in the oil is liberated from the oil. This liberated gas then fills the pores previously occupied by the oil and begins to displace the oil.
 - (2) As reservoir pressure declines, larger quantities of gas will be released and increasing amounts of gas will be produced by the well as oil production declines.
 - (3) Least efficient reservoir drive mechanism; recover from 5% to 30% of the oil in the reservoir.
 - b. Gas-Cap Expansion.
 - (1) Oil in the reservoir is saturated with dissolved gas and excess gas is

compressed and found free in a cap laying over the oil zone.

- (2) Energy to move the oil to the well bore is supplied by the compressed gas cap which tends to flush the oil downward out of the upper portions of the reservoir.
- (3) In addition to the energy from the gas cap, the gas dissolved in the oil will also provide energy to displace the oil.
- (4) Properly operated gas-cap expansion reservoir can recover from 20% to 50% of the oil in the reservoir.
- c. Water Encroachment.
 - (1) Water at the bottom and edges of the reservoir creates pressure against the upper zones of oil and gas.
 - (2) When oil and gas are produced, water will encroach from the bottom of the reservoir flushing the oil and gas upward.
 - (3) Properly operated water encroachment reservoir can recover from 35% to 75% of the oil in the reservoir.
- 3. Combination Drive Reservoir.
 - a. Have free gas in a cap over the oil zone and water under the oil zone.
 - b. Also have dissolved gas in the oil which is released when the reservoir pressure drops.
- 4. Reservoir development must be planned to make maximum use of the natural reservoir energy.
 - a. Improper location or completion of wells can reduce the efficiency of the reservoir drive mechanisms.
 - b. Improper rates of production can reduce the efficiency of the reservoir drive mechanism.
- 5. Enhanced recovery techniques are used to produce oil remaining in the reservoir after natural reservoir drive forces are no longer effective.

- a. Natural reservoir drive forces Primary Production.
- b. Artificial reservoir drive forces Secondary and Tertiary Production. Collectively called "enhanced recovery" techniques.
 - (1) Waterflooding common form of secondary recovery. Inject water in designated wells to flush oil toward a production well.
 - (2) Gas Injection another form of secondary recovery. May also reinject produced gas or water to prolong primary production from the reservoir.
 - (3) Tertiary recovery encompasses the more exotic techniques used to recover residual oil. Can use a solvent, detergent, or heat to move the oil toward the well. For example, carbon dioxide injected into the reservoir will dissovle into the crude oil, reduce its viscosity, and move the oil, or lighter hydrocarbons, toward a production well.
- C. Judicial Reaction to the New Oil and Gas Resource -The Common Law at its Best, and Worst
 - 1. Incorporating oil and gas into the American property system - basic goal of the law has been to establish a system that promotes ownership of property. Regardless of the philosophic foundation one uses to justify the American property system, it is a system of ownership. R. Pound, <u>An Introduction to the Philosophy of Law</u> 108 (rev. ed. 1922).

However, as will be seen, courts initially viewed <u>ownership</u> of oil and gas as a secondary concern to facilitating <u>development</u> of the resource.

- a. Technical problems, a lack of scientific knowledge, prompted courts to adopt an ownership rule which would not hamper development of the resource.
- b. Political tenor of the times: Maximum exploitation of resources to maximize individual gain "The Great Barbecue." See generally Parrington, <u>Main Currents in American Thought</u> 23 (1930). See also Pound,

The <u>Spirit of the Common Law</u> (1921) (noting the common law heritage of "individualism" as a product of its puritan background).

- Policy of the common law was to assign to identifiable owners everything capable of ownership. <u>State v. Pennsylvania R.R. Co.</u>, 228 A.2d 587, 598 (Del. 1967).
 - a. Following this goal, surface ownership of land included ownership to all that lay below or above the confines of the surface boundaries of the land.
 - b. Blackstone summarized the rule stating: "[T]he word 'land' includes not only the surface of the earth but everything under it, or over it."
- 3. Oil and gas presented a unique problem they were "movable" within the reservoir.
 - a. When courts were called upon to determine rights in oil and gas, the geology and mechanics of oil and gas while beneath the earth were still a mystery to the scientific community - and therefore the courts.
 - b. Courts adopted rules based upon a misconception of the dynamics of oil and gas beneath the earth.
 - c. The basic misconception: oil and gas flow beneath the earth unrestrained like water in a free flowing river.
 - (1) Courts likened oil and gas to wild animals and applied similar principles to allocate ownership in the resource.
 - (2) The oil and gas producer thereby became the zookeeper for a menagerie of hydrocarbon fauna labeled by the courts as minerals <u>ferae</u> <u>naturae</u>. See, e.g., <u>Westmoreland & Cambria Natural Gas Co.</u> <u>V. DeWitt</u>, 130 Pa. 235, 18 A. 724 (1889).
 - (3) Some courts thought the resource was renewable and infinite. See, e.g., <u>Wood</u> <u>County Pet. Co. v. West Virginia Trans.</u> <u>Co.</u>, 28 W. Va. 210, 57 Am. Rep. 659 (1886).

4. Courts held true to the common law desire to assign ownership to all property. However, after assigning ownership, based upon ownership of the surface, courts immediately qualified their ownership rule with the "rule of capture."

Although present ownership in the oil and gas was established, it could be "perfected" only by reducing the oil and gas to actual possession - by bringing it to the surface.

- D. Ownership Principles
 - 1. Initially determined by surface boundaries.
 - 2. Owner of the land owns the surface and:
 - a. Ownership-In-Place any minerals beneath the surface.
 - b. Non-Ownership-In-Place no present right to the minerals in place, but the exclusive right to develop minerals that can be produced from beneath the surface.
- E. Rule of Capture.
 - 1. Although the landowner may have a present ownership interest in oil and gas beneath land, rights in the resource are lost once it moves outside surface boundaries.
 - 2. Oil and gas can migrate, within the reservoir, in response to pressure changes created by wells drilled into the reservoir.
 - 3. To perfect ownership of oil and gas, it must be reduced to possession through the process of "capture."
 - 4. The rule of capture protects the adjacent landowner who properly completes a well in the common reservoir and causes oil and gas to migrate across surface boundaries toward their land.
 - a. Adjacent landowners must protect their land from drainage by development of their own land. See, e.g., <u>Barnard</u> <u>v. Monogahela</u> <u>Natural Gas Co.</u>, 216 Pa. 362, 365, 65 A. 801, 802 (1907).
 - b. Rule of capture gives landowners the right to drill wells, bottomed anywhere within the

surface boundaries of their property, in order to obtain title to all the oil and gas they can produce from such wells, even though some or most of it is drained from under land owned by others.

- F. Negative Impacts Caused by the Rule of Capture
 - 1. Rule of capture converts the oil and gas reservoir into a sort of common property with each producer attempting to maximize their individual gain at the expense of others owning rights in the reservoir.

Compare this situation to exploitation of federal grazing lands where each rancher, through the agency of their livestock, attempt to "capture" as much grass as possible. See Hardin, The Tragedy of the Commons, 162 Science 1243, 1244-45 (1968).

2. Waste.

The rule of capture results in various types of waste:

- a. Excessive drilling into the reservoir can result in an inefficient use of the natural reservoir drive resources necessary for maximum recovery of oil and gas.
- b. Drilling in locations which, as a matter of good reservoir engineering, should not be drilled.
- c. Environmental damage and land use demands caused by excessive drilling.
- d. Excessive rates of production which can damage the reservoir and impair maximum recovery of oil and gas.
- Excessive investment in wells which are not technically required to recover the resource
 but necessary to maximize individual recovery under the rule of capture.
- f. Artificially low price for the resource because it is being produced in response to an imperfect rule of property instead of economic indicators.

- G. The Judicial Response Recognition of "Correlative Rights"
 - 1. The correlative rights doctrine recognizes that a person operating a well properly located on their land can significantly affect the rights of other property owners in the same reservoir.
 - 2. Unrestrained, an absolute right to drill and produce as one pleases from a reservoir could destroy the ability of others to try and capture oil and gas beneath their property.
 - 3. Cannot take action which will injure the reservoir so other owners in the common resource are unable to exercise their opportunity to capture.
- H. The Legislative Response "Conservation" Regulation
 - Used to protect correlative rights and "prevent waste."
 - 2. Establishes some ground rules for exercising the right to capture oil and gas.
 - 3. Oil and gas are natural resources in which the public has an interest.
 - 4. Rule of capture causes much of the oil and gas in the reservoir to be wasted through inefficient production practices. Such practices are employed to maximize the individual's self-gain at the expense of the other owners overlying the reservoir.
 - 5. Public's interest obtain maximum recovery of oil and gas at the lowest cost. Failure to obtain maximum recovery at the lowest cost is "waste."
 - 6. Conservation techniques used to prevent or control waste include:
 - a. Location Restrictions require a minimum distance between producing wells and require wells to be drilled a minimum distance from lease or property lines.
 - b. Production Restrictions control the rate of production to achieve orderly removal of the resource.

- c. Pooling permit separate properties to be operated as a production unit to comply with location restrictions.
- d. Unitization operate entire reservoir as a single property unit. Surface boundaries used only to calculate each party's share in total production from the reservoir.
- 7. Each producing state has an administrative agency to manage their oil and gas conservation program.
- IV. THE LAW AND THE SOCIAL WORLD IT ATTEMPTS TO ORDER -PROTECTING THE UNINFORMED
 - A. The Surface and Mineral Estates.
 - 1. Ownership of minerals underlying a tract of land can be conveyed separately from the overlying surface interest.
 - 2. Upon conveyance of an interest in some or all of the minerals in a tract of land, two separate property interests are created: a surface estate and a mineral estate. <u>Zaskey v. Farrow</u>, 159 Kan. 347, 351, 154 P.2d 1013, 1015-16 (1945).
 - a. Two separate fee simple estates are created. Each is potentially infinite in duration and can be disposed of by gift, sale, or inheritance. <u>Crowe Coal & Mining Co. v.</u> <u>Atkinson</u>, 85 Kan. 357, 360, 116 P. 499, 500 (1911).
 - b. Severance of the mineral estate from the surface estate can occur by granting a mineral estate or by granting the surface estate and excepting a mineral estate.
 <u>Shaffer</u> <u>v. Kansas Farmers Union Royalty Co.</u>, 146 Kan. 84, 89, 69 P.2d 4, 7 (1937).
 - c. Conveyance of a mineral estate is accomplished by a document called a "mineral deed." <u>Hickey V. Dirks</u>, 156 Kan. 326, 327, 133 P.2d 107, 109 (1943).
 - 3. Owner of a mineral interest has the right to enter the land encompassed by the mineral interest to explore for, develop, and produce the minerals. <u>Corbin v. Moser</u>, 195 Kan. 252, 257, 403 P.2d 800, 804 (1965).

- a. Can authorize others to develop the property for the mineral interest owner's benefit.
- b. Mineral owners typically do not develop their mineral interest, but instead contract with a developer to conduct exploration, development, and production operations.
- 4. Mineral interest includes the right to develop, the right to authorize others to develop, and the right to any benefits under development contracts with third parties.
- B. Surface Use And Mineral Development.
 - 1. If a mineral deed, or oil and gas lease, merely grants the right to develop oil and gas, without addressing surface access rights to conduct operations, the grantee, or lessee, has an implied right to make reasonable use of the surface to facilitate operations.
 - 2. Texas defines the implied easement to include the right to take materials from the leased land necessary to support reasonable operations under the grant.

For example, in <u>Sun Oil Co. v.</u> <u>Whitaker</u>, 483 S.W.2d 808 (Tex. 1972), the lessee had the right to use fresh groundwater to conduct secondary recovery operations.

NOTE: In <u>Sun</u> the lease provided: "Lessee shall have free use of oil, gas, coal, wood and water from said land except water from Lessor's wells for all operations hereunder . . ." The Court of Civil Appeals held this language was ambiguous and the parties did not intend to allow the use of large quantities of water necessary for secondary recovery operations. However, the Supreme Court held the right to use the water was encompassed by the implied easement without reference to the express lease provisions.

- 3. Dominant/Servient estates.
 - a. Most states view the mineral estate as the "dominant" estate with the surface estate being "servient" to the mineral estate. This has affected, to some extent, the scope of the developer's implied easement.

b. Texas recognizes a limited obligation to

accommodate the surface owner's interests when it can be done without unduly burdening the owner of the mineral interest. <u>Getty Oil</u> <u>Co. v. Jones</u>, 470 S.W.2d 618 (Tex. 1971). However, the Texas accommodation doctrine only applies when the lessee's proposed use unduly impairs lessor's <u>preexisting</u> use of the land and reasonable alternatives exist for the lessee.

c. Kansas does not treat the mineral estate as dominant to the surface estate. The Kansas position is stated in <u>Rostocil v. Phillips</u> <u>Petroleum Company</u>, 210 Kan. 400, 502 P.2d 825 (1972):

> "The obvious intent of the parties under . . . [an oil and gas] lease is that the licensed privileges of the lessee are to run hand in hand with those reserved to the lessor with neither interfering more than need be with the continuing uses of the other - the one for the exploration, production and transportation of minerals and the other for the pursuit of agriculture."

> Although the Kansas approach remains undefined, it would appear an expanded accommodation obligation could be fashioned by the courts. Consider <u>Hunt Oil Co. v.</u> <u>Kerbaugh</u>, 283 N.W.2d 131 (N.D. 1979).

> See generally, Pierce, Toward a Functional Mineral Jurisprudence for Kansas, 27 <u>Washburn</u> <u>L. J.</u> 223 (1988).

- 4. Must the developer pay for surface damage caused by its exercise of the implied easement?
 - a. This is an area undergoing major change. See generally Polston, Surface Rights of Mineral Owners What Happens When Judges Make Law and Nobody Listens? 63 North Dakota L. Rev. 1 (1987).
 - b. Oklahoma Surface Damages Act Okla. Stat. Ann. tit. 52 §§ 318.2 - 318.9 (West 1987).
 - c. See <u>Davis Oil Co. v. Cloud</u>, 57 O.B.J. 2885 (Nov. 22, 1986) (Oklahoma Court of Appeals applies the Act retroactively and refuses to apply a reasonable use standard for determining when surface damages are due.

d. Texas - adheres to the traditional common law rule that so long as the surface use is reasonably necessary for the exploration, production, and marketing of the granted substances, no payment for surface damage is required. (Unless the lease <u>expressly</u> requires payment of damages). <u>Moser v.</u> <u>United States Steel Corp.</u>, 676 S.W.2d 99 (Tex. 1984).

NOTE: <u>Moser</u> limits the free easement rule to substances expressly identified in the grant. Substances included in a grant of "other minerals" requires that the lessee pay for any surface damage relating to their extraction.

- 5. Courts have attempted to protect the surface owner's interests by manipulating title to the resource. If the developer lacks <u>title</u> to substances that require significant surface damage for their extraction, the surface interest is protected. However, other important interests may be thwarted in the process. See Pierce, Toward a Functional Mineral Jurispurdence for Kansas, 27 <u>Washburn L. J.</u> 223 (1988).
- C. What is a Mineral?

A mystery in most states. Courts addressing the issue have not successfully defined the term "minerals" or the phrase "other minerals."

- 1. <u>A</u> conveys to <u>B</u> "all the minerals in Section 30." What substances does <u>B</u> receive by this grant? What does <u>A</u> own? Who owns the oil and gas? Helium, hydrogen, and carbon dioxide? Is coal, recoverable only through surface mining, included in the grant? Do we classify everything as animal, vegetable, and mineral so that <u>B</u> owns the soil on the surface of Section 30?
- 2. Interpretive guides:
 - a. Construe against grantor If the minerals are severed as part of a conveyance of real property, construe the deed against the grantor so as to pass the largest estate possible to the grantee. E.g., Kan. Stat. Ann. § 58-2202 (1983).
 - b. Community knowledge test Include the substance in the definition of minerals only

if it was generally known to exist at the time of the conveyance. See <u>Roth v. Huser</u>, 147 Kan. 433, 76 P.2d 871 (1938).

- c. Surface destruction test Include the substance in the definition of minerals only if it can be extracted without significant destruction of the surface. See <u>Payne v.</u> <u>Hoover, Inc.</u>, 486 So.2d 426 (Ala. 1986).
- d. Miscellaneous factors -

Some courts focus on the unique character of the mineral and refuse to include common varieties of minerals such as sand, gravel, and stone, which require destruction of the surface to mine.

Some courts look to extrinsic evidence of what the parties were attempting to do when the conveyance was made. For example, a conveyance of all minerals to an oil and gas operator may be more limited than a similar conveyance from a father to his son. Some courts declare the conveyance ambiguous and consider extrinsic evidence of each party's intent.

e. Most cases addressing this issue (like the "other minerals") concern mineral <u>conveyances</u> as opposed to mineral <u>leases</u>. When the scope of a mineral deed is at issue, courts are more inclined to construe ambiguous language in favor of the grantee. However, courts will favor the grantor (lessor) when the language appears in an oil and gas lease.

For a statutory statement of this interpretive rule see North Dakota Cent. Code § 47-10-24 (1983).

f. Observation - courts often inclined to adopt a rule for determining "title" to a substance which will not surprise the owner of the surface estate. Scope of the grant often restricted to protect surface estate from a claim to mine unspecified minerals which would cause significant surface damage. D. What Minerals are Included in a Grant of Oil, Gas, and "Other Minerals?"

Texas' attempt to define "other minerals."

- 1. Refuse to apply <u>ejusdem generis</u>. <u>Southland</u> <u>Royalty Co. v. Pan American Petroleum Co.</u>, 378 S.W.2d 348 (Tex. 1964).
- 2. If the severance is made after June 8, 1983 (or if the surface and mineral estates were divided prior to June 8, 1983 but merge and are separated again after June 8, 1983) - the phrase "other minerals" includes "all substances within the ordinary and natural meaning of that word, whether their presence or value is known at the time of the severance." <u>Moser V. United States Steel Corp.</u>, 676 S.W.2d 99 (Tex. 1984).
 - a. However, previous Texas decisions holding a substance belongs to the surface owner, as a matter of law, are still effective. Court in <u>Moser</u> lists cases on building stone, limestone, caliche, surface shale, water, sand, gravel, "near surface" lignite, iron, and coal.

Must still use <u>Acker v. Guinn</u> test to determine what is "near surface" lignite, iron, and coal.

- b. No free "reasonable use" surface easement for substances included under the "other minerals" definition. Must pay for all surface destruction caused when extracting unspecified substances included in the grant.
- c. If the severance is made on or before June 8, 1983, the tests created by <u>Acker v. Guinn</u>, 464 S.W.2d 348 (Tex. 1971); <u>Reed v. Wylie</u>, 554 S.W.2d 169 (Tex. 1977) (<u>Reed I</u>); and <u>Reed v. Wylie</u>, 597 S.W.2d 743 (Tex. 1980) (<u>Reed II</u>) must be used. <u>Friedman v. Texaco, Inc.</u>, 691 S.W.2d 586 (Tex. 1985); <u>Atlantic</u> <u>Richfield Co. v. Lindholm</u>, 714 S.W.2d 390 (Tex. App. 1986).
 - (1) <u>Acker v. Guinn</u> Surface Destruction Test: if you have to destroy the surface to remove an unspecified "mineral," it is not a mineral included in a grant of "other minerals." It belongs to the surface owner.

- (2) <u>Reed I</u> if substantial quantities of the mineral lie so near the surface that extraction, <u>at the time of the</u> <u>conveyance</u>, would consume, deplete, or destroy the surface, the mineral belongs to the surface owner. (holding revised by <u>Reed II</u>)
- (3) <u>Reed II</u> substances "near the surface" are part of the surface estate if any reasonable method of production, at the time of conveyance <u>or thereafter</u>, would consume, deplete, or destroy the surface.
 - (i) Any deposit within 200 feet of the surface is "near the surface" as a matter of law.
 - (11) If surface owner establishes ownership of substance at or near the surface, the surface owner owns the substance at all depths.
- 3. Oklahoma applies the <u>ejusdem generis</u> maxim. <u>Oklahoma</u> <u>v.</u> <u>Butler</u>, 58 Okla. B. J. 3412 (Dec. 8, 1987); <u>Vogel v. Cobb</u>, 193 Okla. 64, 141 P.2d 276 (1943); <u>West v.</u> <u>Aetna Life Ins. Co.</u>, 536 P.2d 393 (Okla.App. 1974).
- 4. The Kansas approach to the "other minerals" problem.
 - a. Kansas courts have applied the community knowledge and surface destruction tests to the "other minerals" situation, but have relied more strongly on the <u>ejusdem generis</u> maxim.
 - b. <u>Ejusdem</u> <u>generis</u> where a general description follows a more specific description, the general is limited to items encompassed by the specific. <u>Keller v. Ely</u>, 192 Kan. 698, 702, 391 P.2d 132, 135 (1964).
 - c. Example: in <u>Keller v. Ely</u> a reservation of "all of the oil, gas, casing-head gas and other liquid semi-solid and solid minerals . . . " was held not to include gypsum because " . . the general terms contained in the reservation must be deemed to embrace and include only those things similar in nature

to those previously specifically enumerated that is, oil, gas and kindred minerals." <u>Keller</u>, 192 Kan. at 703, 391 P.2d at 136.

- đ. Court in <u>Keller</u> also purports to apply the community knowledge test, surface destruction test, and Kan. Stat. Ann. § 58-2202. Similar analytical sequence used in Wulf v. Shultz to hold a lease, granting the right "to dig, drill, operate and procure natural gas, petroleum and other mineral substances." not include the right does to mine [Note: Kan. Stat. Ann. § 58-2202 limestone. not applicable to a mining <u>lease;</u> construe against drafting party - usually grantee instead of the grantor].
- e. Problem with the current state of the law in Kansas - what sequence should be followed in deciding which test or maxim to apply before resorting to other tests or maxims?
- E. The "Conscionable" Unconscionable Contract -The Oil and Gas Lease
 - 1. Basic transaction for developing oil and gas in America is for the landowner to "lease" the minerals, and associated surface easements, to a developer.
 - 2. Generally, the relationship created by the oil and gas lease is not governed by landlord/tenant law.
 - a. Special rules have been developed by the courts to govern the oil and gas lessor/lessee relationship.
 - b. There has also been some statutory intervention governing the relationship. For example: Kan. Stat. Ann. §§ 55-223 through 55-229 (1983) address the lessee's implied obligation to explore and develop the lease.
 - 3. No standard "form" of oil and gas lease. <u>Veverka</u> <u>v.</u> <u>Davies & Co.</u>, 10 Kan.App.2d 578, 584, 705 P.2d 558, 563 (1985) (concurring opinion; no such thing as a "standard" oil and gas lease form, reference to "Producer's 88" is meaningless). <u>Fagg v. Texas Co.</u>, 57 S.W.2d 87 (Tex.Com.App. 1933) ("the character of printed matter contained in any designated class of oil and gas lease form depends on what matter various designers of such forms may deem appropriate - and may vary

accordingly.").

- 4. Although there is no standard <u>form</u> of oil and gas lease, oil and gas leases create a standard <u>relationship</u>. See Pierce, Rethinking the Oil and Gas Lease, 22 <u>Tulsa Law Journal</u> 445 (1987); See generally M. Merrill, <u>Covenants Implied in Oil and Gas Leases</u> §§ 220-223 (2d ed. 1940); Polston, Recent Developments in Oil and Gas Law, 6 <u>Eastern</u> Min. L. Inst. 19-1, 19-2 (1985).
 - a. The relationships created by varying oil and gas lease forms are typically identical in structure.
 - b. Courts and legislatures have fashioned rules to respond to the relationship, not necessarily the terms of a particular lease form.
- 5. The basic structure of the standard relationship consists of the following:
 - a. Lessee given option to conduct operations on the leased land for a specified term.
 - b. Lessee must pay a "rental" if development is not immediately pursued. This is an interim fee to maintain the option in effect.
 - c. If lessee discovers oil or gas during the option period, the grant is extended until it is no longer profitable for the lessee to produce existing wells.
 - d. Lessee pays all the costs and keeps all the revenue, subject to an obligation to pay or deliver a cost-free share of production to lessor.
- F. Basic Structure of the Oil and Gas Lease.
 - 1. The basic structure of the oil and gas lease, like the relationship it creates, has become standardized, consisting of the following clauses:
 - a. Granting Clause.
 - b. Habendum (Term) Clause.
 - c. Drilling/Delay Rental Clause.
 - d. Royalty Clause.

- 2. Granting Clause defines the scope of the rights conferred upon lessee.
 - a. Land encompassed by the grant. Surface and subsurface extent.
 - b. Purpose of the grant.
 - c. Substances encompassed by the grant.

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- d. Easement burdening the surface estate necessary to exercise the grant.
- 3. Habendum (Term) Clause defines the duration of the grant.
 - a. Primary Term the period of time, specified in the lease, during which it will remain in effect. (Subject to the operation of other clauses which may extend or reduce the specified term.)
 - (1) Example: "This lease is for a term of three years from the effective date."
 - (2) Also known as the "term" clause.
 - b. Secondary Term a contingency which extends the lease beyond the primary term.
 - (1) Example: "This lease is for a term of three years from the effective date <u>and</u> <u>so long thereafter as oil or gas, or</u> <u>either of them, is produced from the</u> <u>leased land.</u>"
 - (2) Also known as the "thereafter" clause.
- 4. Drilling/Delay Rental Clause limits the duration of the lease unless the lessee develops the leased land or pays a "rental" to delay development.
 - a. Limitation on the primary term of the lease.
 - Lessee has the option to either drill or pay delay rental. Unless the lessee drills or pays rental, the lease terminates.
- 5. Royalty Clause specifies the lessor's share of production, substances subject to the royalty obligation, costs chargeable to lessor's share, how it will be valued and paid, and when it is payable.

- 6. Miscellaneous Express Clauses most of the remaining clauses found in the typical lease are designed to expand or qualify the operation of the four basic clauses. For example:
 - a. Pooling Clause provides a mechanism to expand the scope of the habendum clause and modify the drilling/delay rental and royalty clauses.
 - b. Completion, dry hole, cessation, shut-in royalty, and force majeure clauses are designed to expand the duration of the lease under the habendum clause.
- 7. Judicially-Defined Implied Obligations express lease clauses are affected by judicial attempts to balance the relative positions of the lessor and lessee under the standard relationship created by the oil and gas lease.
- G. Judicial Paternalism and its Effect on the Resource
 - 1. Habendum Clause Establishes Duration Of The Lease.
 - a. Other clauses, such as the drilling/delay rental clause, may limit the duration of the lease.
 - b. Other clauses may extend the lease.
 - 2. Habendum Clause Creates A "Special Limitation" On The Grant.
 - a. This is an area where the lease "contract" is treated more like a conveyance.
 - b. If the requirements of the habendum clause are not met, the lease terminates. The terms of the habendum clause are a "special limitation" on the leasehold grant. Kansas courts will not extend the grant beyond the period stated in the lease. <u>Reese</u> <u>Enterprises, Inc. v. Lawson</u>, 220 Kan. 300, 310, 553 P.2d 885, 894-95 (1976).
 - (1) Not a forfeiture; no equity to mitigate.
 - (2) Acts of God and the lessee's good faith will not mitigate the termination. <u>Kahm</u> <u>v.</u> <u>Arkansas River Gas Co.</u>, 122 Kan. 786, 791-92, 253 P. 563, 566 (1927).

- 3. Production Requirement.
 - a. Typical habendum clause extends the grant "for so long as oil or gas is produced."
 - b. Kansas Must be actual production at the end of the primary term.
 - (1) Substance must be produced <u>and marketed</u> on the date the primary term ends or the lease terminates. <u>Baldwin v. Oil</u> <u>Company</u>, 106 Kan. 848, 850, 189 P. 920, 921 (1920).
 - (2) Similar rule applied to defeasible term mineral interests. <u>Home Royalty Ass'n</u> <u>v. Stone</u>, 199 F.2d 650, 653 (10th Cir. 1952).
 - c. Oklahoma Discovery of production satisfies the habendum clause. A reasonable time is allowed to initiate marketing of production. <u>McVicker v. Horn, Robinson & Nathan</u>, 322 P.2d 410 (Okla. 1958) (contrasts the Kansas position).
 - d. Texas Follows the Kansas rule. Production requires marketing.
 - e. Well not completed by end of primary term -Lessees responded with express lease provisions allowing lessee to "complete" a well which was "commenced."
 - f. Well completed but unable to market production by end of primary term - Lessees responded with shut-in royalty clause to avoid situations like <u>Elliott v. Oil Co.</u>, 106 Kan. 248, 187 P. 692 (1920), where lessee had, during the primary term, completed several productive gas wells on the land but was unable to get it hooked up to a pipeline prior to the end of the primary term. Held: lease terminated.
 - g. Most leases have a shut-in royalty clause to address the delayed marketing of gas. Consider <u>Collins</u> <u>v.</u> <u>Oil & Gas Co.</u>, 85 Kan. 483, 487-89, 118 P. 54, 56 (1911) where the lessee completed five <u>oil</u> wells but failed to produce because of the depressed price of oil. Held: lease terminated.

- h. Even though the lease is producing when the primary term ends, lease remains in effect only so long as production continues.
- 1. Lease forms often expand the habendum clause by specifying events which will extend the lease without actual production or discovery of production. For example, gas storage, pooling, unitization, shut-in royalty, commencement of а well, operations, completion of a dry hole.
- 6. Paying Quantities.
 - a. Phrase "so long as oil or gas is produced" means produced in paying quantities. Pray v. <u>Premier Petroleum, Inc.</u>, 233 Kan. 351, 353, 662 P.2d 255, 257 (1983); <u>Clifton v. Koontz</u>, 160 Tex. 82, 325 S.W.2d 684 (1959).
 - (1) Same rule applied to defeasible term mineral interests. <u>Texaco, Inc. v. Fox</u>, 228 Kan. 589, 582, 618 P.2d 844, 847 (1980).
 - (2) Commercial quantities = paying quantities. <u>Texaco, Inc.</u> <u>v.</u> <u>Fox</u>.
 - c. To maintain a lease, or defeasible term mineral interest, the lessee must:

"[0]perate the lease to produce those quantities of oil or gas which will produce a profit, however small, over operating expenses, after eliminating the initial cost of drilling and equipping the well or wells on the lease which are required to prepare the lease for production."

Reese, 220 Kan. at 314, 553 P.2d at 897.

- d. To determine profit, Kansas courts use an objective test which employs a mathematical computation. If gross income exceeds lease operating costs, there is production in paying quantities.
 - (1) Lessee's good faith judgment regarding profitability immaterial.
 - (2) Objective approach goal keep lessee from holding unprofitable leases for speculation. <u>Reese</u>, 220 Kan. at 314,

553 P.2d at 897.

- (3) NOTE: waiting for the price of oil to rise to make the operation profitable would seem to be the sort of speculation the objective approach is designed to prevent.
- e. Texas Approach <u>Clifton</u> <u>v. Koontz</u>, 160 Tex. 82, 325 S.W.2d 684 (1959):

"In the case of a marginal well, . . . the standard by which paying quantities is determined is whether or not under all the relevant circumstances a reasonably prudent operator would, for the purpose of making a profit and not merely for speculation, continue to operate a well in the manner in which the well in question was operated."

Whether there is a reasonable basis for the expectation of profitable returns from the well is the test."

- f. Two major problems in determining profitability:
 - (1) What items to charge as expenses and include as income; and
 - (2) The period of time over which profitability should be considered.
- G. Understanding Oil and Gas Lease Jurisprudence
 - 1. The body of law developed to govern the rights of the landowner/mineral owner and developer under the oil and gas lease is a product of:
 - A judicial recognition that the landowner/ mineral owner didn't really know what they were doing when they entered into the lease; and
 - b. A reluctance by the courts to police the situation head-on through the traditional remedies of fraud, misrepresentation, duress, mistake, and unconscionability.
 - 2. Instead, courts have used their power to "interpret" contracts and conveyances to make a better deal for the landowner/mineral owner - a deal more in line with what the lessor would have

required had they known what they were doing.

- 3. Use of "Standard" Forms The oil and gas lease is not written to be read, it is written to be signed.
 - a. All the aura of other neatly printed documents - the negotiation process typically consists of filling in the names of the parties and the date.
 - b. Courts view the lease as a document drafted by the lessee for the lessee.
- 4. As I have noted in previous writings:

"A major reason for endurance of the [oil and lease] relationship is the willingness of gas courts to take what they perceive to be an unfair contract and make it fair through creative interpretation. This 'unfairness' arises out of a of perceived combination substantive and procedural unconscionabilities visited upon the The familiar targets of judicial scrutiny lessor. focus upon the consideration paid for the lease and the lessor's expectation of development to Because the lease gives the generate royalty. lessee the exclusive right to develop the any express obligation to property, without develop, courts imply varying obligations on the lessee to ensure diligent development.

"A court willing to police the bargin head-on might find such a contractual arrangement substantively unconscionable. Similarly, the court might find procedural unconscionability in the cryptic code the oil and gas lease form employs to express the respective rights of the parties. Although the print is legible [barely], and the lessor is given an opportunity to read it, most lessors, and attorneys unfamiliar with the 'code,' will not appreciate its scope and effect."

Pierce, Rethinking the Oil and Gas Lease, 22 <u>Tulsa</u> L. J. 445, 453-54 (1987).

V. FAILURES OF THE COMMON LAW

- A. The Classification Game
 - 1. Courts, lawyers, and law professors, have a propensity to employ the common law process of "legal" reasoning to solve new problems in old

contexts. Although this provides some desired predictability to the law, it does not necessarily result in the best, or most logical, set of rules to govern a new problem.

Tendency to try and force new problems into old common law classifications to arrive at rules which are supposed to seem universal - or at least established at the time the issue arose.

- 2. What is an oil and gas "lease"?
 - a. A conveyance or contract? What statute of frauds will we apply? Conveyance or contract? NOTE: Standard oil and gas lease form provides only for the landowner/mineral owner's signature.
 - b. Will landlord-tenant law apply? One area where courts have generally refused to apply available common law rules.
 - c. Is the oil and gas lease a "lease" under other statutory provisions - such as § 365(h) of the Bankruptcy Code (lessee of <u>real</u> <u>property</u> has option to remain in possession of leased premises for duration of rejected lease).
 - d. Is the oil and gas lease an "executory contract" under § 365 of the Bankruptcy Code?
- B. The Kansas Oil and Gas Lease Classification Experience
 - 1. Mineral Interest.
 - a. Surface and mineral estates are real property. <u>Froelich v. United Royalty Co.</u>, 178 Kan. 503, 507, 290 P.2d 93, 96 (1955), <u>modified</u>, 179 Kan. 652, 297 P.2d 1106 (1956).
 - b. Granting an oil and gas lease covering the mineral estate does not change ownership of the minerals. Merely burdens the mineral estate with contractual obligations specified in the oil and gas lease.
 - 2. Oil and Gas Lease.
 - a. Classified as personal property. <u>Burden v.</u> <u>Gypsy Oil Co.</u>, 141 Kan. 147, 150, 40 P.2d 463, 466 (1935).

- b. Peculiar classification probably adopted to exempt oil and gas leases from K.S.A. § 79-420 (1984).
- c. K.S.A. § 79-420 does not apply to "leases" (although it was probably intended to do so). <u>Gas Co. V. Neosho County</u>, 75 Kan. 335, 337, 89 P.750, 751 (1907).
- 3. Oil and gas lease has been, in effect, reclassified by statute and judicial opinion to be treated as a real property interest in specified situations.
- 4. Classifying oil and gas lease as personal property has created a number of problems. How do we fit this personal property interest, which affects interests in land, into the Kansas property administration scheme?
 - a. Personal property can be abandoned but not lost by adverse possession. K.S.A. § 60-503 (1983) (adverse possession) applies only to real property.
 - b. Where do we record a security interest in an oil and gas lease? UCC records - as a personal property interest; or with the register of deeds as a mortgage?

Ingram v. Ingram, 214 Kan. 415, 521 P.2d 254 (1974). Bank filed as a mortgage affecting real estate, if UCC applied, bank would lose its priority position. Court notes Kansas treats the oil and gas lease as a "hybrid "the property interest" and holds: determined oil and gas legislature has leasehold interests are to be treated as real property under the statutes pertaining to the of recording instruments conveying or affecting real estate."

Ingram, 214 Kan. at 420-21, 521 P.2d at 259 (emphasis by the court).

c. Also have problems determining whether a particular statute or remedy applies to the oil and gas lease.

<u>Utica Nat. Bank and Trust Co. v. Marney</u>, 233 Kan. 432, 661 P.2d 1246 (1983). Whether oil and gas leases held by Marney were subject to the automatic judgment lien provisions of K.S.A. § 60-2202 (1983). Court holds § 60-2202 places a lien only on "real estate" of the judgment debtor and therefore does not apply to an oil and gas lease.

5. Must recognize the "hybrid character" of oil and gas property interests and plan your transactions accordingly.

Must classify the interest and then determine if there have been any judicial or statutory reclassifications to fit it into the state's property administration system.

- 6. Courts may, from time to time, change the classifications. See, e.g., <u>Tex. Am. Energy V. Citizens Fidelity B.</u>, 736 S.W.2d 25 (Ky. 1987) (Departing from prior Kentucky precedent, court holds previously extracted gas, stored in a confined reservoir, is personal property "goods" governed by the Uniform Commercial Code).
- C. The Neglected "Public Interest"-Fallout from a Polarized Jurisprudence
 - 1. Courts and Conservation Commissions usually serve a "referee" function when dealing with oil and gas disputes. Their focus is on the competing interests of the lessor and lessee, the large and small developer, or between co-owners of the development rights.

The public is seldom represented, or considered, in fashioning remedies among the warring factions.

- 2. Courts and Conservation Commissions, however, resolve disputes between the represented parties which can have a significant impact on public resource interests.
- 3. Lease Interpretation basic approach is to interpret against the lessee to promote the interests of the lessor. Should courts ever consider the impact of their interpretaion on public interests?
 - a. Parties are contracting with regard to a natural resource in which the public has a keen interest.
 - b. <u>Restatement (Second) of Contracts</u> § 207 (1981): "In choosing among the reasonable meanings of a promise or agreement or a term

thereof, a meaning that serves the public interest is generally preferred."

- c. Fairly uncharted area in contract law.
- 4. Paying Quantities Requirement. Does it promote the public interest? Implied covenants requiring, in some cases, unnecessary development? See Pierce, Rethinking the Oil and Gas Lease, 22 <u>Tulsa</u> <u>L. J.</u> 464-72 (1987).
- 5. Other types of public interests, of an institutional nature, may be affected by efforts to protect a party to the oil and gas transaction.
 - a. "Minerals" and "Other Minerals" interpretive problems. If you adopt interpretive rules to protect a party from non-fraudulent conduct, by requiring consideration of factual matters outside of the written document, it may be impossible to determine, from the recorded documents, ownership of the resource.
 - Adversely affects commerce in the property interest because ownership cannot be readily determined. Also thwarts public interests promoted through recording systems. See Pierce, Toward a Functional Mineral Jurisprudence for Kansas, 27 <u>Washburn L. J.</u> 223 (1988).
- 6. The public has been satisfied with focusing on disputes (or legislation) at the Public Utility Commission level without considering major energy decisions (which impact the ultimate cost of energy) at the Conservation Commission level.

Traditional focus has been on "use" conservation instead of "production" conservation.

- a. Most attempts to eliminate all the negative vestiges of the rule of capture have failed because the participants in the process (large developers, small developers, and royalty owners) were each attempting to maximize their self-interest in the process.
- b. If the public were actively involved, it would tend to break the deadlock between the developers and royalty owners which has tended to prevent effective production conservation. It would also inject new considerations in the legislative,

administrative, and judicial processes which have traditionally not been weighed.

See generally Pierce, Coordinated Reservoir Development - An Alternative to the Rule of Capture for the Ownership and Development of Oil and Gas: Part I, 4 J. of Energy L. & Policy 1-79 (1983); Part II, 4 J. of Energy L. & Policy 129-70 (1983).

- VI. LEARNING THE TRADE OIL AND GAS LAW AS A VEHICLE FOR LAWYER SKILLS TRAINING
 - A. The Law Student to Lawyer Process
 - Phase I learning basic legal principles ("the law")

Usually accomplished simultaneously with Phase II.

- 2. Phase II ordering the "mush"
 - a. Focus on developing analytical skills.

"The mark of a master is that facts, which before lay scattered in an inorganic mass, when he shoots through them the magnetic current of his thought, leap into an organic order and live and bear fruit."

Oliver Wendell Holmes, Jr.

- b. Student becomes functional at evaluating facts and applying legal principles to the facts.
- c. If all goes well, student should be able:

"[T]o analyze the facts presented by [a] question, . . . select the material from the immaterial facts, and to discern the points upon which [a] case turns. [Understand] the pertinent principles and theories of law, their relationship to each other, and their qualifications and limitations. [A]pply the law to the facts given . . . "

Instructions to California Bar Examination

d. When the law student completes law school, they are generally proficient at analyzing the law and facts and identifying legal problems.

- 3. Phase III After employing analytical skills to identify a problem, take the analytical process two steps further:
 - a. To develop a <u>plan</u> for solving (or avoiding) the problem; and
 - b. Execute the plan through:
 - (1) Counselling
 - (2) Drafting
- B. Mineral Deed Exercise
 - 1. Phase I
 - a. Essential elements of a conveyance.
 - b. "Other Minerals" problem. See Pages 21-25.
 - c. Mineral/Royalty problem.
 - d. Surface Use problem. See Pages 19-21.
 - e. Apportionment of Royalty problem.
 - f. "<u>Duhig</u>", "<u>Hoffman</u> Two-Grants", and related exception problems.
 - 2. Example of the Phase I Process: The Apportionment of Royalty Problem.

Most states hold that when a landowner leases land, and then subsequently conveys a divided portion of the land to a third party, royalty from production will be paid to the owner of the land where the well is located. This is called the nonapportionment rule.

For Example: <u>A</u>, owner of the minerals in Section 30, leases to <u>X</u> on 1 January 1988. On 2 January 1988 <u>A</u> conveys the minerals in the Southwest Quarter of Section 30 to <u>B</u>. On 1 February 1988 a producing well is completed on the Southwest Quarter of Section 30.

Applying the nonapportionment rule, <u>B</u> will receive all the royalty from the well located on the Southwest Quarter. Lessee <u>X</u> can maintain the lease and drain oil and gas from <u>A</u>'s portion of the land. <u>A</u> has no remedy against \underline{X} or <u>B</u>.

Sometimes the Oil and Gas Lease will alter the nonapportionment rule by including an "entireties clause" which allocates production between <u>A</u> and <u>B</u> based upon their mineral ownership in the entire leased area (Section 30). Under an entireties clause <u>A</u> and <u>B</u> would share proportionately in all production from anywhere on Section 30.

If the lease does not contain an entireties clause, the parties should be counseled regarding its effect and consider how to address the problem in the conveyance document.

Arkansas, Kansas, Nebraska, Oklahoma, and Texas (and other states) appear to follow the nonapportionment rule.

California, Mississippi, and Pennsylvania appear to permit apportionment.

Phase I we study various cases to understand the apportionment problem and the reasons courts have taken differing approaches to the problem.

- 3. Phase II
 - a. Presented with a factual situation that creates substantive problems examined in Phase I.
 - b. Identify the pertinent facts.

NOTE: Even at Phase II there has been a "lawyering" skill introduced. Instead of narrating the facts, the facts are presented in a realistic setting - a sales contract and oil and gas lease. An additional component could be included through client interviews where you would learn, for example, the client is planning to use part of the land for irrigated agriculture.

- c. Identify the issues raised by the facts.
- d. Apply the applicable law to the facts.
- e. Traditional Analysis we have these problems:
 - (1) What is required to create an effective conveyance?

- (2) Ambiguity created by "other minerals" language.
- (3) How do you ensure your conveyance will create a mineral interest as opposed to a royalty interest?
- (4) Big Oil will receive the perpetual right to use the surface to develop the mineral estate.
- (5) Since a divided interest is being created after the property was leased, have an apportionment problem.
- (6) How should I protect Nancy against a breach of warranty relating to the encumbrance created by the oil and gas lease?
- 4. Phase III
 - a. Counselling Opportunities
 - (1) Do you intend to convey coal or other substances besides oil and gas?
 - (2) Are you aware of the surface burdens created by mineral development?
 - (3) Apportionment rule.
 - b. The Drafting Process
 - (1) Ensure you have mastered Phases I and II.
 - (2) Choice of Law Kansas.
 - (3) Evaluate problems and determine how they can best be addressed - plan you document.
 - (4) Draft document to activate your plan.
 - (5) Supervise the process; administer the document to ensure its effectiveness. May involve counselling your client on future behavior, obligations, etc.

Particularly important when representing lessor under an Oil and Gas Lease. Lessees routinely attempt to alter rights created by lease through subsequent documents called Division Orders.

- 5. Learn how to use the law to accomplish basic tasks. Learn basic drafting skills which can be applied in any legal discipline.
- 6. The skills training process:
 - a. Provide student with the relevant documents which establish the task they must perform.
 - b. Student drafts the necessary documents.
 - c. Edit documents, return and discuss.
 - d. Discuss the analytical process, the drafting process, and provide students with your suggested approach to the problem.
 - e. Repeat the entire process at least once.
- See: Oil & Gas Law Practical Exercise #1 Typical Student Response to the Exercise My Suggested Approach to the Exercise My Approach Disected to Demonstrate Analysis

OIL & GAS LAW Practical Exercise #1

MINERAL INTEREST SALES AGREEMENT

Nancy Farmer ("NANCY") agrees to sell, and Big Oil Company ("BIG") agrees to buy, for \$50,000, the following property: All the oil, gas, and other minerals in the Southwest Quarter of Section 30, Township 36 South, Range 10 East, in Eureka County, Kansas (the "Property").

Under the following terms:

1. NANCY warrants title to the Property. However, BIG agrees to accept the Property subject to the following encumbrances: Oil and Gas Lease between NANCY and Major Petroleum Corporation recorded in Book 5, at Page 240, in the Eureka County Register of Deeds office ("Lease"). A copy of the Lease is attached as Exhibit A to this Agreement.

2. NANCY will have the deed prepared and available for inspection by BIG's legal counsel, David E. Pierce, by 3:00 p.m. 14 October 1987 at the University of Tulsa School of Law. Any objections to the form of conveyance will be raised by BIG at that time.

3. All rights and obligations under this Agreement, and the interests conveyed pursuant to this Agreement, shall bind and benefit the heirs, successors, and assigns of NANCY and BIG.

SIGNED 6 October 1987.

ancu tarmer

NANCY FARMER 132 Autumn Lane Claremore, Oklahoma 74017

end end

LEVI (ZENDT Attorney-in-Fact BIG OIL COMPANY 727 Katy Freeway Houston, Texas 77001

ASSIGNED TASK

You represent Nancy Farmer, draft the deed required by Section 2 of the Agreement which will be effective to convey the property to Big Oil Company. Be prepared to discuss the form and terms of your conveyance document. What matters would you like to discuss with Nancy concerning this transaction? You can use <u>any</u> resource to complete this exercise. AAPL FORM 690

19 87 . by and briven . hereinafter day of SEPTEMBER called Levor, and MAJOR PETROLEUM CORPORATION THIS AGREEMENT, made and entered into this **3RD** NANCY FARMER

. hereinafter called Lessee

WITNESSETH:

B640.00

1. That Lenser for and in consideration of the sum of $\underline{D600.00}$ Dullare in hand paid, receipt of which is hereby arrance and the covenance and arresteres hereby arrance and the covenance and arresteres hereby arrance and the covenance of arrester and here of a presents hereby arrance and the covenance of the and one of the model of the rest of the lense of any part thereof with other Oil and Gas Lesses are of all covered hereby a hereinfer described. With the right on unities this Lesse or any part thereof with other Oil and Gas Lesses are of all covered hereby and for the purpose of carrying on resolution, resolvation, work, including and the other Oil and Gas Lesses including and the dilling. minimize, and overation for the purpose of carrying on resolvation, and for construction work, including tank, storing oil. building power stations, and other structures thereon meesary or conversion of and banding of stand almee, or conjointly with neighboring Land, to produce, save, take care of, and manufactures all of subtance, and for the bowing and barding of employees, and more structures thereon meesary or conversion for the economical oversion of said land almee, or conjointly with neighboring Lands, to produce, save, take care of, and manufactures all of subtance, and for the bowing and barding of employees, and react of land with any reversionary right, therein, being airuated in the County of EUREKA.

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2. This Lease shall remain in force for a primary term of _____ be produced. 3. Levee shall deliver to Levon as royalty. free of cost, on the Leaw, or into the priorline to which the Lease may connect its well, the equal one eighth part of all oil produced and saved from the leaved premines, or at the Levee's option, may pay to the Leveor for such one-eighth royalty the market price for oil of like grade and gravity prevailing on the day such oil is run into the pipeline or into storage tanks.

4. Leves thall pay to Leton for gas produced from any oil well and used by the Levese for the manufacture of gasoline or any other product. as regalty, one-eighth of the market value of such gas at the mouth of the well; if said gas is soild by the Leves, then as royalty, one-eighth of the proceeds of the sale thereof at the mouth of the well. The Leves shall pay Leson as royalty one-eighth of the groceeds from the sale of gas as such at the mouth of the the primary term hercof, and such well or welk are shut-in, and there is no other production, drilling operations or other operations being conducted capable of keeping this Lease in force under any of its provisions. Lesse shall pay as royalty to Lessor (and if it be within the primary term hereof such payment shall be in liku of delay rentals) the sum of \$1.00 per year per net royalty acre, such payment to be made to the depository bank hereinafter named on or before the anniversary date of this Leave next ensuing after the expiration of 90 days frum the date such well or wells are shut-in, and thereafter on the well where gas only is found. Where there is a gas well, or wells on the lands covered by this Lease or acreage product therewith, whether it be before or after anniversary date of this Lease during the period such wells are shur-in, and upon such payment it shall be considered that this Lease is maintained in full force 3RD and effect.

, 19 BB . this Leave shall terminate as to both parties unless the Lessee shall on or before said date par Bank, at . or its successors, which bank and its successors are the Lersor's apent, and shall continue as a depository of any and all sums payable under this Lease regardless of changes in ownership in said lands or in the oil and gas or in the s. If operations for the drilling of a well for oil or gas are not commutanced on said lands on or before the _ SEPTEMBER ROGERS COUNTY BANK CLAREMORE OKLAHOMA

dar of

remails to accue bereauder, the sum of $\underline{B}640.00$ Ibiliars which shall operate as a rental and cover the privilege of deferring the commencement of operations for dividing for a period of one year. In like manner and upon like payments or tenders the commencement of operations for dividing members of further deferred for like period of one year. In like manner and upon like payments or tenders the commencement of operations for a period of one year. In like manner and upon like payments or tenders the commencement of operations for dividing the periods uncessively. All payments on the context of the context of operations for any average thereof mailed or delivered on or before the result paying date, either direct to Levue or his axis, or to usid depositors have and it is understood and arreed that the conditention from the date of here rights franced to the date when valid first rested beets. The day may easily and all other rights conferred to the Levue's option of extending that period as aforetaid, and any and all other rights conferred bereis. Notwithstanding the death of the Levue or his uccessers in interest, the payment or tender of rentals in the manner above set out shall be binding on the heirs, devices, executors and administrators of \$640,00

such persons.

6. If at any time prior to the discovery of oil or gas or other hydrocarbons on this land and during the term of this Lase the Levee shall drill a dry bode or holes on vaid land. This Leave shall not terminate, provided operations for the drilling of a well thall be commenced by the meat ensuing rental paying date, or provided that the Levee begins or resumes the payment of rentals in the manner and amount hereinabove provided for, and in this event the preceding paragraphs hereof governing the payment of rentals and the manner and effect thereof shall continue in force.

7. In case said Lensor owns a lenser interest in the above described land than the entire and undivided fee simple easte therein, then the *royaltien* and rentals herein provided for shall be paid Lenson many in the proportion which his interest bears to the whole and undivided fee. Failure to proportionately reduce the rental hereinabove provided for shall have no effect on the right to reduce royalties to correspond with Lensor's actual interest in the above described lands. The rental above provided for shall be increased at the next succeeding rental paying date after any reversion occurs to cover the interest so acquired by the Lessor. 8. Lesses shall have the right to use. free of cost, gas, oil and water found on said land for its operation thereon, except water from the wells of the Lessor. When required by Levsor, the Levses shall bury its pipelines below plow depth and shall pay for damages caused by its operations to growing crops on said land. No well shall be drilled mearer than 200 feet to any house or harn now on said premises without the written constant of the Levses. Lesses shall have the right at any time during, or after the expiration of this Lease, to remove all machinery, fixtures, houses, buildings and other arrectures placed on said premises, including the right to draw and remove all conter shall be under no obligation to do so, nor shall Lessee be under any obligation to restore the surface to its original condition where any alterations or changes were due to operations reasonably necessary under this Lease.

extend to the heir, devices, executors, administrators, successors and assigns, but no change of ownership in the lands or in the rentals or royalties, or any num due under this Leaw shall be binding on the Levee until it has been furnished with either the original recorded instrument of the conveyance or a duly certified copy thereof, or a certified copy of the Will of any deceased owner and the probate thereof, or a certified copy of the proceedings showing the appointment of an administrator of the estate of any deceased owner is appropriate, together with all original recorded instruments of conveyance or duly certi-fied copies thereof necessary to show a complete chain of title back to Lessor to the full interest claimed, and all advanced payment of rentals made hereunder 9. If the estate of either party hereto is assigned, and the privilege of assigning in whole or in part is expressly allowed, the covenants hereof shall before receipt of such documents shall be binding on any direct or indirect assignce, grantee, devisee, administrator, executor or heir of the Lessor.

which the lands covered by this Lease may be divided by sale, device, dexent or otherwise, or to furnish separate measuring or receiving tanks. It is further agreed that in the event this Lease shall be assigned as to a part or as to parts of the above described land and the holder or owner of any such part or parts shall make default in the payment of the proportionate part of the rental due from him, such default shall not operate to defeat or affect this Lease insofar as it covers a part of said land upon which the Lesse or any assignee hereof shall make due payment of said rentals. If six or more parties become entitled to royalty payments hereunder Lessee may withhold payment thereof unless and until furnished with a recordable instrument executed by all such parties 10. No change or division in the ownership of the land, rentals or royalties, however accomplished, shall operate to enlarge the obligation, nor diminish the rights of the Lesse. In the event of assignment hereof in whole or in part, lishility for breach of any obligation hereunder shall rest exclusively upon the owner of this Lesse, or portion thereof who commits such breach. There shall be no obligation on the part of the Lesse to offset wells on separate tracts into designating an agent to receive payment for all. 11. Letsor hereby warrants and agrees to defend title to the lands herein described and agrees that the Lesser at its option may pay and discharge in whole or in part any taxes, mortgages or other liens existing, levied or assessed on or against the above described land and in the event it exercises such option it shall be subrogated to the rights of any holder or holders thereof and may reimburse itself by applying to the discharge of any such mortgage, tag or other lien, any royalty, shut-in royalty, or rentals accruing hereunder. 12. Notwithtanding anything in this Lease contained to the contrary, it is expressly agreed that if the Lease shall commence operations for drilling at any time while this Lease is in force, this Lease shall remain in force and its terms shall continue so long as such operations are prosecuted and, if production results therefrom, then as long as production continues. 13. If within the primary term of this Lease, production on the leased premises shall cease from any cause, this Lease shall not terminate provided operations for the drilling of a well shall be commenced before or on the next criving rental paying date; or, provided lesse begins or resumes the payment of rentals in the manner and amount hereinbefore provided. If, after the expiration of the primary term of this Lease, production on the **leased premises** thalf cease from any cause, this lease shall not terminate provided lesse resumes operations for drilling a well within sinty (60) days from such cessation, and this lease shalf remain in force during the prosecution of such operations and, if production results therefrom, then as long as production continues.

14. Letter may at any time surrender or cancel this Leate in whole or in part by delivering or mailing a releate to the Letter, or by placing same of record in the proper county. In case said Leate is surrendered and cancelled at to only a portion of the acrage covered thereby, then all payments and liabilities thereafter accruing under the terms of asid Leate at to the portion cancelled shall cease and terminate and any rentals thereafter paid may be ap-portioned on an acreage basis, but as to the portion of the acreage not releated the terms and provisions of this Leate shall continue and remain in full force ind effect for all purposes.

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Mid-Custinent Boyalty Owners Association Approved Perm Revised



AREAS BLUE PRINT CO. INC.

MINERAL DEED

ENOW ALL MEN BY THESE PRESENTS THAT NANCY FARMER

-132 AUTUMN LANE CLAREMORF OK hereinafter called Grantor, (wh te) for as Over Mast Pe sonsideration of the sum of. FIFTY THOUSAND Dollars (\$.50.000 cash in hand paid and other good and valuable considerations, the receipt of which is hereby acknowledged, hereby grant, bargain, sell, convey, transfer, assign and deliver unto BIG OIL COMPANY hereby grant, hargain, sell, convey, transfer, assign and deliver unto # 727 Katy Freeway HOUSTON TX100% called Grantee (whether one or more) an undivided. and to all of the oil, gas and other minerals in and under and that may be produced from the following described lands site EUREKA County, State of KANSAS wit:

SOUTHWEST QUARTER of SECTION 30 TOWASHEP 36 SOUTH, RANGE 10 EAST

containing 160 acres, more or less, together with the right of ingress and egress at all times for the purpose of mining, drilling, exploring, operating and developing said lands for oil, gas, and other minerals, and storing, handling, transporting and marketing the same therefrom with the right to remove from said land all of Grantee's property and improvements.

This sale is made subject to any rights now existing to any lease or assigns under any valid and subsisting off and gas lease of record heretofore executed; it being understood and agreed that said Grantee shall have, receive, and enjoy the herein granted undivided interest in and to all bonuses, rents, royalties and other benefits which may accrue under the terms of said lease insofar as it covers the above described land from and after the date hereof, precisely as if the Grantee herein had been at the date of the making of said lease the owner of a similar undivided interest in and to the lands described and Grantee one of the lessors therein.

making of said reste the owner of a similar undivided interest in and to the minis described and Grantee one of the rights berein Grantor agrees to execute such further assurances as may be requisite for the full and complete enjoyment of the rights berein granted and likewise agrees that Grantee herein shall have the right at any time to redeem for said Grantor by payment, any mortgage, taxes, or other liens on the above described land, upon default in payment by Grantor, and be subrogated to the rights of the holder thereof.

TO HAVE AND TO HOLD, The above described property and essement with all and singular the rights, privileges, and appurtenances thereunto or in any wise belonging to the said Grantee herein <u>175</u> heirs, successors, personal representatives, administrators, acceutors, and assigns forever, and Grantor do<u>C</u>, hereby warrant said title to Grantee <u>175</u> beirs, executors, administrators, personal representatives, successors and assigns forever and do<u>C</u>, hereby agree to defend all and singular the said property unto the said Grantee herein <u>175</u> heirs, successors, executors, personal representatives, and assigns against every person whomsoever claiming or to claim the same or any part thereof. WITNESS <u>Phy</u> hand this <u>14 th</u> <u>day of OCTODEY</u> 18 87

14 th my WITNESS. hand this 0 ncu tarmer

STATE OF KANSAS	KNOWLEDGMENT FOR INDIVIDUA	L (Kans. Okla. and Colo.)
Before me, the undersigned, a Notary Public, within	and for said County and State, on this	14+1
day of October 1987, p	rsonally appeared NANCY FAR	MER
and		
to me personally known to be the identical person who exect	red the within and foregoing instrumen	It and acknowledged to me
IN WITNESS WHEREOF. I have bereunto set my han	d and official stal the day and year us	surposes therein set forth
Ny commission errires 11-5-89	MUNIC Lour	
	CHUCK ROAST	Notary Public
STATE OF]		
COUNTY OF	ACKNOWLEDGMENT FOR CO.	RPORATION
Be it remembered that on thisday of		
Notary Public, duly commissioned, in and for the county and a	tate aforesaid, came	
yresident of		
a corporation of the State of	, personally known to me to	be such officer, and to be
the same person who executed as such officer the foregoing ins	trument of writing in behalf of said co	rporation, and he duly ac-
IN WITNESS WHEREAF I have hereints and my ha	nd and official and an the day and w	eer last above written.

My commission expires_____

Approved to unalpractice? ANSAS BLUE PRINT CO. Inc. Rearder No. 09-195 2 1% Berfifter + ? & Ben 700- Burtan (Ba MINERAL DEED Bes this serve any po KNOW ALL MEN BY THESE PRESENTS THAT about saying: LOOKY HERE FOLKS reinafter called Grantor, (whether one a) for and in dant want to disclose . Dollars (8 onsideration of the sum of. Sabably eashin hand paid and other good and valuable considerations, the receipt of which is hereby acknowledged, do hereby grant, bargain, sell, convey, trensfer, assign and deliver unto r 3 ths an morest? undivided called Grantee (wheth an (undivided one or and to all of the oil gas and other minerall in and under and that may be produced from the follo eribed lands sit How about merely saying for valuable Such as COAL ? mnemi/voyatty problem - do not include words at grant associated With personal property exception to grant or university? Containing acres, more or less, together with the right of ingress and egress at all times for the purpose of mining, drilling, exploring, operating and developing said lands for oil, ras, and other minerals, and storing, handling, transport-ing and marketing the same therefrom with the right to remove from said land all of Grantee's property and improvements. This sale is made subject to any rights now existing to any lesses or assigns under any valid and subsisting oil and gas lesse of record heretofore executed; it being understood and agreed that said Grantee shall have, receive, and enjoy the herein granted undivided interest in and to all bonuses, rents, royalties and other benefits which may accrue under the terms of said lease insofar as it covers the above described land from and after the data hereof, precisely as if the Grantee herein had been at the date of the making of said lease the owner of a similar undivided interest in and to the lands described and Grantee one of the leasors therein. Grantor agrees to execute such further assurances as may be requisite for the full and complets enjoyment of the rights herein granted and likewise agreet that Grantee herein shall have the right at any time to redeem for said Grantor by payment, any of the holder thereof. TO HAVE AND TO HOLD, The above described property and essement with all and singular the rights, privileges, and appurtenances thereunto or in any wise belonging to the said Grantee herein. heirs, successors, personal reptatives, administrators, executors, and assigns forever, and Grantor do.... hereby warrant said title to Grantee beirs, executors, administrators, personal representatives, successors and assigns forever and do... hereby arres to defend all and singular the said property unto the said Grantee berein. wirs, successors, executors, personal r tives, and assigns against every person whomsoever claiming or to claim the or any part thereof. need to except lease encumbrances WITNESS. is this acceptable? broader than contract vervices surface use problems? apportionment issue two grants problemi STATE OF. as, ACKNOWLEDGMENT FOR INDIVIDUAL (Kans. Okla. and Colo.) COUNTY OF. Before me, the undersigned, a Notary Public, within and for said County and State, on this personally appeared. day of <u>th.</u> meet coment law requiremen Does o me personally known to be the identical person. who executed the within and foregoing instrument and acknowledged to me executed the same as free and voluntary act and deed for the uses and purposes therein set forth. IN WITNESS WHEREOF, I have hereunto set my hand and official seal the day and year last above written. My commission expires Notary Public Is this habendum clause necessary STATE OF. ACKNOWLEDGMENT FOR CORPORATION COUNTY OF. , before me, the undersigned. a Be it remembered that on this day of 19_ Notary Public, duly commissioned, in and for the county and state aforesaid, came president of a corporation of the State of ______, personally known to me to be such officer, and to be the same person who executed as such officer the foregoing instrument of writing in behalf of said corporation, and he duly acknowledged the execution of the same for himself and for said corporation for the uses and purposes therein set forth. IN WITNESS WHEREOF, I have bereunto set my hand and official seal on the day and year last above written. My commission expires Notary Public

MINERAL DEED

NANCY FARMER, a single person, ("NANCY") for valuable consideration, conveys and warrants to BIG OIL COMPANY, a Texas corporation with its principal offices at 727 Katy Freeway, Houston, Texas 77001 ("BIG"):

> All the oil, gas, and similar hydrocarbon substances in and under the Southwest Quarter of Section 30, Township 36 South, Range 10 East, in Eureka County, Kansas,

hereafter called the "Mineral Interest."

Subject to the following:

SECTION 1. <u>Rights Granted as Part of the Mineral</u> <u>Interest</u>. As part of the Mineral Interest, BIG has the exclusive right to develop, or authorize others to develop, the Mineral Interest. Subject to SECTION 2 of this Mineral Deed, BIG is entitled to any bonus, rental, royalty, or other payments which may accrue, after the date of this Mineral Deed, in existing leases or development contracts affecting the Mineral Interest. BIG is entitled to any reversionary interest NANCY may have in existing leases or development contracts affecting the Mineral Interest.

BIG is also given the right to enter and use the surface overlying the Mineral Interest to the extent necessary to explore, develop, produce, and operate the Mineral Interest, pursuant to the following terms:

[Enumerate rights of NANCY and BIG in the surface.]

Section 2. <u>Apportionment of Royalties</u>. The Mineral Interest is currently subject to the Oil and Gas Lease described in SECTION 3 of this Mineral Deed, which covers all of Section 30, Township 36 South, Range 10 East, in Eureka County, Kansas, hereafter called the "Leased Land." After the date of this Mineral Deed, when production is obtained anywhere on, or attributable to, the Leased Land, BIG and NANCY will share in all royalty, or shut-in royalty, in the following proportions:

> NANCY - 3/4ths BIG - 1/4th

If the Oil and Gas Lease on the Leased Land expires or otherwise ceases to burden the Leased Land, then each owner of mineral rights in the Leased Land will be released from any obligation, created by this SECTION, to apportion royalties.

SECTION 3. <u>Exceptions to the Warranty</u>. There is excepted from the warranty an encumbrance created by an Oil and Gas

Lease between NANCY and Major Petroleum Corporation dated 3 September 1987 and recorded in Book 5, at Page 240, of the Miscellaneous Records of Eureka County, Kansas.

SECTION 4. <u>Binding Effect</u>. This grant, and all related terms, are binding on the heirs, personal representatives, successors, and assigns of NANCY and BIG.

SIGNED and DELIVERED 14 October 1987.

ACKNOWLEDGMENT CERTIFICATE

Wilson County, Kansas

This Mineral Deed was acknowledged before me on 14 October 1987 by NANCY FARMER.

(SEAL)

CHUCK ROAST, Notary Public My commission expires: 1-22-90

<u>MINERAL DEED</u> [Title consistent with a mineral interest.]

NANCY FARMER, a single person, ("NANCY") for valuable consideration, conveys and warrants to BIG OIL COMPANY, a Texas corporation with its principal offices at 727 Katy Freeway, Houston, Texas 77001 ("BIG"):

[Identify parties, address of grantee for future tax statement mailings. Recital of consideration - optional.]

[Indicate marital status of grantor - homestead and inchoate statutory rights of spouse. Kan. Stat. Ann. § 59-401, § 60-2301, Kan. Const. art. 15, § 9. Kan. Stat. Ann. § 59-505.]

[Statutory short form for words of conveyance. Kan. Stat. Ann. § 58-2203.]

> All the oil, gas, and similar hydrocarbon substances [other mineral problem] in and under [mineral/royalty problem] the Southwest Quarter of Section 30, Township 36 South, Range 10 East, in Eureka County, Kansas,

[Description of property being conveyed. Kan. Stat. Ann. § 58-2203 and § 58-2204. Luthi v. Evans, 223 Kan. 622 (1978).]

hereafter called the "Mineral Interest."

Subject to the following:

SECTION 1. <u>Rights Granted as Part of the Mineral</u> <u>Interest</u>. As part of the Mineral Interest, BIG has the exclusive right to develop, or authorize others to develop, the Mineral Interest. Subject to SECTION 2 of this Mineral Deed, BIG is entitled to any bonus, rental, royalty, or other payments which may accrue, after the date of this Mineral Deed, in existing leases or development contracts affecting the Mineral Interest. BIG is entitled to any reversionary interest NANCY may have in existing leases or development contracts affecting the Mineral Interest.

[Applying Kansas precedent to ensure conveyance is interpreted as a mineral interest.]

BIG is also given the right to enter and use the surface overlying the Mineral Interest to the extent necessary to explore, develop, produce, and operate the Mineral Interest, pursuant to the following terms:

[Must coordinate respective rights to use surface.]

Section 2. <u>Apportionment of Royalties</u>. The Mineral Interest is currently subject to the Oil and Gas Lease described in SECTION 3 of this Mineral Deed, which covers all of Section 30, Township 36 South, Range 10 East, in Eureka County, Kansas, hereafter called the "Leased Land." After the date of this Mineral Deed, when production is obtained anywhere on, or attributable to, the Leased Land, BIG and NANCY will share in all royalty, or shut-in royalty, in the following proportions:

NANCY - 3/4ths BIG - 1/4th

If the Oil and Gas Lease on the Leased Land expires or otherwise ceases to burden the Leased Land, then each owner of mineral rights in the Leased Land will be released from any obligation, created by this SECTION, to apportion royalties.

[Kansas applies the nonapportionment rule. <u>Carlock v. Krug</u>, 151 Kan. 407 (1940). Must address matter in deed because the oil and gas lease does not contain an entireties clause. <u>Brubaker v. Branine</u>, 237 Kan. 488 (1985).]

SECTION 3. Exceptions to the Warranty. There is excepted from the warranty an encumbrance created by an Oil and Gas Lease between NANCY and Major Petroleum Corporation dated 3 September 1987 and recorded in Book 5, at Page 240, of the Miscellaneous Records of Eureka County, Kansas.

[To avoid <u>Duhig</u> and <u>Hoffman</u> line of problems, simply indicate whether the exception is being made to the grant or to the warranty.]

SECTION 4. <u>Binding Effect</u>. This grant, and all related terms, are binding on the heirs, personal representatives, successors, and assigns of NANCY and BIG.

[Not required in Kansas. Kan. Stat. Ann. § 58-2202. However, I prefer to add this clause when the deed contains some reciprocal covenants - such as surface use agreements and apportionment of royalty. Want to ensure these are covenants which will "run with the land."]

SIGNED and DELIVERED 14 October 1987.

[Must be signed by grantor. Kan. Stat. Ann. § 58-2209. Delivery and acceptance is required to make the conveyance effective. Acceptance is presumed in most cases.]

Nancy Farmer

[Acknowledgment required for recording. Kan. Stat. Ann. § 58-2212.]

[Acknowledgment certificate in this document uses a statutory short-form of acknowledgment. Kan. Stat. Ann. § 53-509.]

ACKNOWLEDGMENT CERTIFICATE

Wilson County, Kansas

This Mineral Deed was acknowledged before me on 14 October 1987 by NANCY FARMER.

(SEAL)

CHUCK ROAST, Notary Public My commission expires:

[Must record promptly or conveyance is void. Kan. Stat. Ann. § 79-420.]

See generally D. Pierce, <u>Kansas Oil and Gas Handbook</u> 5-2 to 5-14 (Kansas Bar Association 1986).

VII. MUCH TO BE DONE

- A. A Frontier for Thought
 - 1. Many basic jurisprudential issues remain unresolved.
 - 2. Discoveries in states where oil and gas have not been previously found.
 - 3. Reevaluation of existing jurisprudence.
 - 4. Problem solving at the conceptual and "doer" levels.
 - 5. New regulatory demands.
 - a. Enforcement of environmental regulations.
 - b. Decentralized regulation of the transportation and sale of gas.
 - 6. The role of the public in oil and gas matters.
- B. A Frontier for Action
 - 1. Finite nature of the resource.
 - 2. Inevitable transfers of wealth at all levels.
 - 3. Energy policy.
 - 4. A discipline in need of original scholarly thought.



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Title: OIL AND GAS LAW IN THE LEGAL EDUCATON PROCESS

Date: April 30, 1988

Location: Branson, Missouri

Program: Annual Meeting of the Central States Law School Association

Sponsor: Central States Law School Association

Duration: Two Hours