TEN THINGS KANSAS ATTORNEYS SHOULD KNOW ABOUT OIL & GAS LAW

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by

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I. OIL AND GAS ARE NOT FOUND IN UNDERGROUND CAVERNS OR STREAMS

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 contain 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.
II. TO PERFECT OWNERSHIP THERE MUST BE A WELL THROUGH WHICH OIL AND GAS ARE "CAPTURED"

A. Ownership Initially Determined by Surface Boundaries.

1. Owner of the land owns the surface and any minerals beneath the surface.

2. Kansas, in Zinc Co. v. Freeman, 68 Kan. 691, 696, 75 P.995, 997 (1904), adopted the "ownership in place" theory of oil and gas ownership.

   a. The person vested with title to land is deemed to presently own, in addition to surface rights, any oil, gas, or other minerals which may be located beneath the surface boundaries of the land. Magnusson v. Colorado Oil and Gas Corp., 183 Kan. 568, 574, 331 P.2d 577, 582 (1958); Gas Co. v. Neosho County, 75 Kan. 335, 337-38, 89 P. 750, 751-52 (1907) (ownership in place rule applied to oil and, in a companion case, to natural gas).

   b. Upon receiving title to a parcel of land, the landowner obtains a present right to all oil, gas, and other minerals within the land.

B. Rule of Capture.

1. Although the landowner has a present ownership interest in oil and gas beneath their land, rights in the resource are lost once it moves outside surface boundaries. Zinc Co. v. Freeman, 68 Kan. 691, 696, 75 P. 995, 997 (1904).
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.
   b. Rule of capture gives landowners the right to drill wells, bottomed anywhere within the surface boundaries of their property, and to obtain legal title to all the oil and gas they could produce from such wells, even though some or most of it was drained from under land owned by others.

5. Kansas Supreme Court recently applied the rule of capture to the production of natural gas injected into a gas storage reservoir. The party injecting the gas was not a public utility authorized to condemn the reservoir for storage, nor had it obtained the right to use the reservoir underlying adjacent lands. Anderson v. Beech Aircraft Corp., 237 Kan. 336, 699 P.2d 1023 (1985).

6. Although Kansas recognizes the rule of capture, the landowner has certain rights which can be enforced to protect oil and gas while still in the reservoir - correlative rights and conservation regulation.

III. THE STATE HAS PLACED RESTRICTIONS ON HOW OIL AND GAS CAN BE CAPTURED

A. 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.

B. Conservation Regulation.

1. 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 a strong 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. Ensure the resource is not used for inferior purposes. 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. In Kansas pooling is not required by statute. Voluntary pooling agreements are "encouraged" by production restriction practices.
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. Kansas Corporation Commission administers the Kansas oil and gas conservation program.

IV. "MINERAL" RIGHTS CAN BE CONVEYED AWAY FROM THE "SURFACE" RIGHTS

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. Zaskey v. Farrow, 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. Crowe Coal & Mining Co. v. Atkinson, 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 (and reserving) a mineral estate. Shaffer v. Kansas Farmers Union Royalty Co., 146 Kan. 84, 89, 69 P.2d 4, 7 (1937).


B. The Mineral Estate.

1. 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. Corbin v. Moser, 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.

2. 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.

C. Right to Use Surface Estate to Develop Mineral Estate.

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

NOTE: In Sun 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. In Kansas the scope of the surface easement remains undefined.

a. Thurner v. Kaufman, 237 Kan. 184, 188, 699 P.2d 435, 439 (1984) ("Under an oil and gas lease, the lessee has the implied right to make reasonable use of the surface in order to develop the land for the oil and gas." - dicta).

4. 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. Getty Oil Co. v. Jones, 470 S.W.2d 618 (Tex. 1971). However, the Texas accommodation doctrine only applies when the lessee's proposed use unduly impairs lessor's preexisting 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 Rostocil v. Phillips Petroleum Company, 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 Hunt Oil Co. v. Kerbaugh, 283 N.W.2d 131 (N.D. 1979).


5. Must the developer pay for surface damage caused by its exercise of the implied easement?


c. See Davis Oil Co. v. Cloud, 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, or marketing of the granted substances, no payment for surface damage is required. (Unless the lease expressly requires payment of damages). Moser v. United States Steel Corp., 676 S.W.2d 99 (Tex. 1984).

NOTE: Moser 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.

6. Courts have attempted to protect the surface owner's interests by manipulating title to the resource. If the developer lacks title 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 Jurisprudence for Kansas, 27 Washburn L. J. 223 (1988).

V. A CONVEYANCE OF "ALL MINERALS" DOES NOT CONVEY "ALL MINERALS"

A. 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. A conveys to B "all the minerals in Section 30." What substances does B receive by this grant? What does A 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 B 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 Roth v. Huser, 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 Wulf v. Shultz, 211 Kan. 724, 728, 508 P.2d 896, 900 (1973).
   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 conveyances as opposed to mineral leases. 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. See Keller v. Ely, 192 Kan. 698, 700-01, 391 P.2d 132, 134 (1964); In re Estate of Trester, 172 Kan. 478, 483, 241 P.2d 475, 478 (1952).

B. What Minerals are Included in a Grant of Oil, Gas, and "Other Minerals?"

Texas' attempt to define "other minerals."


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." Moser v. United States Steel Corp., 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 Moser lists cases on building stone, limestone, caliche, surface shale, water, sand, gravel, "near surface" lignite, iron, and coal.

Must still use Acker v. Guinn 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 Acker v. Guinn, 464 S.W.2d 348 (Tex. 1971); Reed v. Wylie, 554 S.W.2d 169 (Tex. 1977) (Reed I); and Reed v. Wylie, 597 S.W.2d 743 (Tex. 1980) (Reed II) must be used. Friedman v. Texaco, Inc., 691 S.W.2d 586 (Tex. 1985); Atlantic Richfield Co. v. Lindholm, 714 S.W.2d 390 (Tex. App. 1986).

1. Acker v. Guinn - 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. Reed I - if substantial quantities of the mineral lie so near the surface that extraction, at the time of the conveyance, would consume, deplete, or destroy the surface, the mineral belongs to the surface owner. (holding revised by Reed II)

3. Reed II - substances "near the surface" are part of the surface estate if any reasonable method of production, at the time of conveyance or thereafter, 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.

   (ii) If surface owner establishes ownership of substance at or near the surface, the surface owner owns the substance at all depths.

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 *ejusdem generis* maxim.

b. *Ejusdem generis* - where a general description follows a more specific description, the general is limited to items encompassed by the specific. *Keller v. Ely*, 192 Kan. 698, 702, 391 P.2d 132, 135 (1964).

c. Example: in *Keller v. Ely* 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." *Keller*, 192 Kan. at 703, 391 P.2d at 136.

d. Court in *Keller* 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," does not include the right to mine limestone. [Note: Kan. Stat. Ann. § 58-2202 not applicable to a mining lease; 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?

VI. "MINERAL" OWNERSHIP CONSISTS OF MANY RIGHTS WHICH CAN BE INDIVIDUALLY CONVEYED

A. The Mineral Estate

1. Can divide the mineral estate as follows:

   a. Divided Interest.

   Example: A owns all the mineral estate in Section 30. A conveys to B all the minerals in the East 1/2 of Section 30.

   b. Undivided Interest.

   Example: A conveys to B an undivided one half interest in all the minerals in Section 30.

   c. Term Interest.

   Example: A conveys to B all the minerals in Section 30 for a term of 3 years.

   d. Defeasible Interest.

   Example: A conveys to B all the minerals in Section 30 for so long as oil or gas is produced from Section 30.

   e. Defeasible Term Interest.

   Example: A conveys to B all the minerals in Section 30 for 3 years and so long as oil or gas is produced from Section 30.

   f. Future Interests.

   Example: A conveys all the minerals in Section 30 to B for life, remainder to C.

   g. Depth Limitations.

   Example: A conveys to B all the minerals in Section 30 from the surface down to 3000 feet below the surface.

   h. Substance Limitations.

   Example: A conveys to B all the natural hydrocarbon gas in Section 30.
i. Nonparticipating Interests.

Example: A conveys to B 1/16th of all oil and gas produced from Section 30, free of any of the costs of production. [NOTE: under Kansas law, this conveyance violates the Rule Against Perpetuities.]

j. Combination of the noted limitations.

2. Can also subject the mineral estate to contractual limitations.

a. Most common contractual limitation is the granting of a license to explore, develop, and produce oil and gas.

b. License called an "Oil and Gas Lease."

B. The Leasehold Estate.

1. Usually the mineral interest owner transfers their development rights to a person or entity specializing in oil and gas development.

a. Instrument used to transfer development rights called an "Oil and Gas Lease."

b. The lessee (developer) obtains the mineral interest owner's right to enter the premises and conduct exploration, development, and production operations.

2. When a lease is granted the lessor still owns all the mineral interest. None of the minerals have been conveyed to the lessee. The lessee merely has a contractual right to develop and produce minerals from the mineral estate. The mineral interest owner's property right in the minerals is subject to the terms of the oil and gas lease.

3. Under the oil and gas lease the landowner typically receives compensation in the form of a bonus, possible delay rental, and a cost-free share of any minerals produced, called a royalty.

a. Bonus - money paid by developer (lessee) to induce mineral interest owner (lessor) to enter into an oil and gas lease.

b. Delay Rental - money paid to lessor by lessee, pursuant to an oil and gas lease, as
rent for the privilege of delaying drilling operations on the leased land.

c. Royalty - a share of oil and gas produced from the mineral interest free of any costs of production.

4. Leasehold estate can be fractionated much like the mineral interest. Absent limiting language in the lease, A can assign divided, undivided, term, defeasible term, and various future interests out of the leasehold. A can limit the assignment by depth or substance.

5. Any rights carved from the leasehold estate are limited by the terms of the oil and gas lease. If the lease terminates, anything created out of the lease will likewise terminate. See Campbell v. Nako Corporation, 195 Kan. 66, 402 P.2d 771 (1965).

6. Leasehold Interest or Working Interest - refer to the rights which the lessee has under the oil and gas lease (the basic right being the right to "work" the property for the granted minerals).

a. Assignment of an undivided interest in the leasehold gives the assignee an undivided working interest - often called an "operating" interest because the assignee can enter and work the property subject to the lease.

b. Can also create "nonoperating" interests in the leasehold. Nonoperating means the holder of the interest does not have the power to enter the leased premises to conduct development operations. It is merely an economic interest in oil and gas when, and if, it is produced. Common nonoperating interests include:

(1) Overriding Royalty - a right to a share of oil and gas from the leased land free of the cost of production. Payable out of the working interest from which it is carved.

(2) Production Payment - a right to a share of oil and gas from the leased land free of the cost of production but limited to a specified quantity or value of production.
(3) Net Profits Interest - a right to a share of oil and gas from the leased land free of the cost of production but payable only when the lessee earns a net profit from its operations. Difficulty is defining what costs will be deducted from revenue to determine whether a net profit has been realized.

7. Oil and gas lease typically requires lessee to pay lessor a fraction (traditionally 1/8th) of production as a royalty. This would entitle the lessee to, the remaining 7/8ths of production from which the lessee would pay for the costs of exploration, development, and production.

Any nonoperating interests created by lessee will be payable out of lessee's share of production.

For example: A leases his mineral estate to B. The lease entitles A to a 1/8th royalty. B is entitled to the remaining 7/8ths of production, but must pay 8/8ths of all costs of production.

To obtain funds to help pay for the drilling, B assigns an overriding royalty to C which entitles C to 1/16th of 8/8ths of all oil and gas produced from the leased land. Production and costs will be allocated as follows:

B (lessee) pays 8/8ths of the costs [under the terms of the oil and gas lease and the overriding royalty assignment].

B will receive 13/16ths of the production [7/8ths granted under the oil and gas lease less 1/16th of 8/8ths of production assigned to C].

A will receive 1/8th of the production [under the terms of the oil and gas lease].

C will receive 1/16th of the production [under the terms of the overriding royalty assignment].

D. Nonparticipating Mineral Interests.

1. Kansas courts have had difficulty conceptualizing the nonparticipating mineral interest. This difficulty has been caused, primarily, by the inability of draftsmen to clearly create a nonparticipating mineral interest.
2. The incidents of mineral ownership can be separately owned and conveyed. Incidents of mineral ownership include:

   a. The right to enter the land encompassed by the mineral interest to explore for and develop minerals.

   b. The right to grant such rights to others — often referred to as the "executive" or "leasing" right.

   c. The right to receive benefits payable to the mineral interest owner under any development contract. Typically this will be the right to receive bonus, delay rental, and royalty under an oil and gas lease.

3. When the right to develop the minerals, and the right to authorize others to develop, is severed from the remaining rights under the mineral interest, the interest is called a "nonparticipating" mineral interest.

   a. Owner of the interest cannot "participate" in the development of the minerals.

   b. Often the term nonparticipating is used to describe the specific incident of mineral ownership which has been severed. For example, if A has a mineral interest, but the conveyance excepts the right to receive delay rental, A's interest may be described as a mineral interest which is nonparticipating as to delay rental.

4. Interpretive problems occur when A intends to create a nonparticipating mineral interest but fails to clearly express its intent. A court may seize upon the specific conveyance or exception of incidents of mineral ownership as an indication a royalty interest was intended. This is the "mineral/royalty" problem discussed in the next section of this outline.

VII. DETERMINING WHETHER A CONVEYANCE CREATES A "MINERAL" OR A "ROYALTY" INTEREST

A. Distinction and Importance of the Distinction.

1. Mineral Interest — a right to oil and gas in place
with the right to develop or authorize development.

2. Royalty Interest - a right to share in oil and gas when it is produced; no right to develop or authorize development of the minerals.

3. Importance of the Distinction:
   a. Royalty owner need not be included as a party to the oil and gas lease. No right to develop, so no right to authorize development.
   
b. Value of interest affected by whether it is cost-free or whether it must pay a proportionate share of the development costs.
   
   (1) 1/8th royalty entitles owner to a 1/8th share of production.
   
   (2) 1/8th mineral interest entitles owner to 1/8th share of production less 1/8th of the costs of production.
   
c. If at the time the 1/8th interest is conveyed the mineral interest is subject to an oil and gas lease providing for a 1/8th royalty to the landowner:

   (1) Conveying a 1/8th royalty will entitle the grantee to a 1/8th cost-free share of production.
   
   (2) Conveying a 1/8th mineral interest will entitle the grantee to a 1/64th (1/8th x 1/8th royalty payable under the lease) cost-free share of production.
   
d. If found to be a mineral interest, it must be recorded or listed in accordance with K.S.A. §79-420 (1984).

e. If found to be a royalty interest, it may be void as a violation of the rule against perpetuities.

B. Labels Not Determinative.

1. The term "royalty" is often inaccurately used to refer to a mineral interest owner's reversionary interest in minerals which are subject to an oil

a. Since mineral owner receives 1/8th royalty pursuant to an oil and gas lease covering the minerals, mineral owner might refer to their mineral interest as a "royalty."

b. Problem becomes compounded when they view their mineral interest as constituting a 1/8th royalty.

Mineral owner intending to convey an undivided one-half mineral interest may, in error, express it as a conveyance of 1/16th royalty in the land. See *Powell v. Prosser*, 12 Kan.App.2d 626 (1988).

2. True nature of the instrument determined by the intent of the parties as expressed in the specific terms of the instrument.

C. The Interpretive Process.

1. Primary goal - ascertain the intention of the parties.

a. Look at all language used anywhere in the instrument. (Four-corners rule). Terms of the granting clause given particular weight.

b. The title given an instrument is not determinative. However, the contents of the instrument must make it clear it is something other than what its title indicates.

2. Factors Kansas courts have focused on to resolve the mineral/royalty issue include:

a. Does the instrument convey an ownership interest in oil and gas prior to its actual production?

b. Does the grantee have the right to enter the property to conduct development operations?

c. Does the grantee have the right to lease or otherwise authorize others to develop the property?

3. Courts look for a conveyance or exception of rights commonly associated with a mineral interest.
4. Any Right to Oil and Gas Prior to Production?

a. Mineral Interest - Look to granting clause, and the other parts of the instrument, to determine if it conveys any right to oil and gas "in and under" the land, or any similar language which indicates a right to oil and gas prior to its severance from the land. Shepard v. John Hancock Mutual Life Ins. Co., 189 Kan. 125, 132, 368 P.2d 19, 24-25 (1962).

b. Royalty Interest - Conveys a right to oil and gas when "produced" or otherwise severed from the land. Lathrop v. Eyestone, 170 Kan. 419, 422, 227 P.2d 136, 142 (1951).

c. Many times the instrument conveys an undivided portion of "the oil, gas and other minerals in and under, and that may be produced from" the land.

(1) Shaffer v. Kansas Farmers Union Royalty Co., 146 Kan. 84, 91-92, 69 P.2d 4, 9 (1937). Court finds that the phrase "and that may be produced from" is not a limitation on the grant of "oil, gas and other minerals in and under the land."

(2) Drach v. Ely, 237 Kan. 654, 658, 703 P.2d 746, 750 (1985). Court finds similar language used in a will "refers to a mineral interest rather than a royalty interest and standing alone does not create any ambiguity."

(3) Powell v. Prosser, 12 Kan.App.2d 626 (1988). Conveyance of oil and gas "in and under and that may be produced from" certain land creates a mineral interest.

5. Right to Enter the Property to Conduct Development?

a. Mineral Interest - The presence of language giving grantee the right to enter the property (right of ingress and egress) has been relied upon as indicating a mineral interest was intended. Shaffer v. Kansas Farmers Union Royalty Co., 146 Kan. at 90-91, 69 P.2d at 8 ("statement of the right of the owner of the oil to have some means of getting it.")
b. Royalty Interest - Lack of right to enter property found significant in holding an instrument excepting "a one sixteenth (1/16) Royalty interest in all oil, gas, or mineral in place" reserves a royalty interest. *Corbin v. Moser*, 195 Kan. 252, 257, 403 P.2d 800, 804 (1965).

6. Right to Develop the Property or Authorize Others to Develop?

a. Similar analysis to the presence of right of ingress and egress. If these rights are identified as being part of the interest conveyed, the conveyance creates a mineral interest.

b. If the interest does not possess these rights, the conveyance may create a royalty interest.

7. What inferences should be drawn from the presence or absence of the right of ingress and egress, the right to develop the property, or the right to authorize others to develop?

a. For example, if the instrument is silent regarding the grantee's right to enter and develop the property, or to lease it and receive bonus, delay rental, and royalty, should we infer the grantor intended to convey a royalty interest instead of a mineral interest?

However, since these are all incidents of a mineral interest, why should we state them at all? Would this tend to indicate we are creating something other than a mineral interest?

b. Contrast the two most recent statements by the Kansas Supreme Court on the subject:

*Cosgrove v. Young*, 230 Kan. 705, 642 P.2d 75 (1982). Holding an instrument granting "one-half (1/2) of the royalty in Oil and Gas produced upon the . . . land" creates a royalty interest, the court considers the following factors:

"No right of ingress and egress is granted. No reference is made to oil, gas and other
minerals in and under the land. In short, no further reservations were made in the contract relating to transferability, leasing rights, or other factors previously considered significant by the court. There is nothing in the instrument indicating that more than a bare royalty interest was intended to be conveyed."

**Cosgrove**, 230 Kan. at 712-13, 642 P.2d at 81-82.

**Drach. v. Ely**, 237 Kan. 654, 703 P.2d 746 (1985). Will devised undivided interest in "the oil, gas and other minerals in and under and that may be produced from" six quarter sections of land. However, excluded from the grant were "any of the oil, gas or mineral lease rentals, delay rentals or bonuses which may be payable under any leases upon said real estate . . . ." **Drach**, 237 Kan. at 655, 703 P.2d at 748.

Holding this creates a mineral interest, the court notes:

"If the testator had intended to convey only a royalty interest to his children, there would have been no reason to specify that each surface owner would receive the rentals and bonus paid on his or her property. The other five children would have no claim to such payments and they would inure to the benefit of the surface owner without any such provision." **Drach**, 237 Kan. at 658-59, 703 P.2d at 750.

D. Recognition of the Nonparticipating Mineral Interest.

1. Perhaps the major reason for mineral/royalty problem is a general lack of understanding regarding the nonparticipating mineral interest. However, recent cases recognize the nonparticipating mineral interest - when the document adequately reflects that is what was intended by the parties.

2. In **Powell v. Prosser**, 12 Kan.App.2d 626 (1988), Ansel, by a document, titled "Oil and Gas Royalty Conveyance," granted "an undivided one sixteenth (1/16) interest in and to all the oil, gas and other minerals in and under and that may be
produced from" described land to Adrian. However, Ansel retained the right to lease the entire mineral interest. In the event the property was leased, Adrian would, in addition to royalty, be entitled to 1/2 of all the bonus and delay rental provided for in the lease.

a. Concluding that Adrian had been conveyed a mineral interest instead of a royalty interest, the court observes:

"The above wording, [making it unnecessary for Adrian to join in the execution of an oil and gas lease covering the property] taken by itself, would be indicative of the granting of a royalty interest. However, the conveyance further explains and justifies the court's conclusions that a mineral interest is intended by including the following provision conveying to the grantee [Adrian] a share of the bonus and delay rentals:

'The grantee, . . . shall be entitled to one half (1/2) of all bonus or consideration paid for any oil and gas lease that may be made covering said premises and one half of all rentals that may be paid thereunder.'

"The provision for giving the grantee one-half of the bonus and delay rentals without the right to lease is totally consistent with the intention of granting a present interest in the minerals while leaving with the grantor the sole discretion as to the time and conditions under which a lease might be granted."

Powell, 12 Kan.App.2d at 631.

b. The court concludes its analysis stating:

"Ansel . . . reserved control of the executive or leasing rights, but the granting of one-half of the bonuses and rentals shows the conveyance was of a mineral interest."

Powell, 12 Kan.App.2d at 631.

c. Adrian received a nonparticipating mineral interest as to the leasing or executive rights; he had, however, the passive right
VIII. THE "NEW MATH" OF OIL AND GAS LAW: 1/16 = 1/2

A. Conveying Minerals Subject to an Oil and Gas Lease.

1. Frequent problems in this area because the person drafting the conveyance document fails to recognize the landowner's continued ownership of an 8/8ths mineral interest even though it is under lease providing for a 1/8th royalty.

2. The error typically occurs as follows:

A wants to convey a one-half mineral interest to B. A owns all the mineral interest in Section 30, but it is under lease to C. The lease provides that A will receive 1/8th of the production from the lease as royalty. A's conveyance to B states:

"A grants unto B an undivided 1/16 interest in and to all the oil, gas and other minerals whatsoever in and under Section 30. If such land is covered by a valid oil and gas or other mineral lease B shall have an undivided 1/2 interest in the royalties, rentals, and proceeds therefrom."

a. Does B have a 1/16th or a 1/2 interest in the Section 30 minerals?

b. Presented with a similar conveyance, the court in Heyen v. Hartnett, 235 Kan. 117, 679 P.2d 1152 (1984), found the conveyance ambiguous and employed rules of construction to ascertain the parties' intent. Holding the instrument conveyed a 1/2 mineral interest, the court was influenced by the "widespread confusion" associated with expressing fractional mineral interests which are under lease.

2. Confusion relates to what the grantor has when their mineral interest is leased. They still own all or 8/8ths of the mineral interest. The interest is merely limited by the terms of the lease contract. A cannot develop, because he has granted that right, by contract, to C. One of A's rights under the contract is receipt of a fractional share of all oil or gas produced from the lease. However, A can still convey all, or part, of his mineral interest.
3. Kansas courts will look at all provisions in the instrument, the surrounding circumstances, and applicable rules of construction [such as K.S.A. §58-2202 (1983)] to ascertain the intent and purpose of the parties in using fractions to describe the interest conveyed.

4. The court in Powell v. Prosser, 12 Kan.App.2d 626 (1988), recently applied the Heyen v. Hartnett reasoning and held a conveyance of 1/16th of the oil and gas in and under certain land should be interpreted to convey a 1/2 mineral interest. Other portions of the conveyance document, following the granting clause, gave the grantee rights to at least a 1/16th royalty and 1/2 of any bonus and delay rental. The court observes:

"This difficulty is occasioned where it is not understood that owners of mineral interests still own all of the minerals even if they are subject to a lease reserving to the mineral interest owners one-eighth or some other fractional royalty. As a consequence, the conveyancer wishing to convey a one-half mineral interest expresses it by conveying one-sixteenth of the minerals, erroneously believing, since the land is under lease, one-half of his interest is one-half of the one-eighth royalty or one-sixteenth."

Powell, 12 Kan.App.2d at 632.

5. Drafting to avoid the problem - when conveying fractional mineral interests, refer to the fraction conveyed without reference to the landowner's royalty.

a. Example: A wants to convey B a 1/4th mineral interest, the land is under lease providing for payment of a 1/8th royalty. The instrument should refer only to the 1/4th mineral interest without addressing the grantee's resulting interest in royalty.

A conveys to B an undivided 1/4th of 4/4ths of the oil, gas, and similar hydrocarbon substances in Section 30 . . . .

b. A general statement, concerning the incidents of mineral ownership, can be used if it is phrased in terms of a "1/4th interest in all rights under existing leases on the property" as opposed to a "right to a 1/32 cost-free share of production from the property."
B. Fractional Royalty vs. Fraction "Of" Royalty.

1. Landowner conveys "1/16th royalty," landowner conveys 1/16th of all production from the land. If mineral interest is leased giving landowner a 1/8th royalty, the landowner is deemed to have conveyed 1/2 of his 1/8th royalty. Bellport v. Harrison, 123 Kan. 310, 311, 255 P.52, 54 (1927) (contract for purchase of "1/16th royalty" in land conveyed 1/2 of landowners' 1/8th royalty).

2. Landowner conveys "1/16th of his 1/8th royalty," the landowner is deemed to have conveyed 1/16th of 1/8th or a 1/128th royalty. Hickey v. Dirks, 156 Kan. 326, 133 P.2d 101 (1943). Problem: 1/16th of 1/8th of royalty. Does this mean 1/16th of 1/8th of 1/8th? Or 1/16th of 1/8th?

3. Guide: If there is no limitation on the source for the fractional interest, it will be calculated based on an entire (8/8ths) mineral interest. See Corbin v. Moser, 195 Kan. 252, 403 P.2d 800 (1965).

C. Conveying Fractional Interests When Grantor Owns A Fractional Interest.

1. A owns a 3/4ths mineral interest in Section 30. A conveys a 1/2 mineral interest in Section 30 to B. Does B get a 1/2 mineral interest (1/2 x 4/4) or a 3/8ths mineral interest (1/2 x 3/4)?

   a. B gets a 1/2 mineral interest.

   b. K.S.A. §58-2202 (1983) dictates that B receive a 1/2 mineral interest, even though A only owns a 3/4ths mineral interest and intended to convey only a 3/8ths (1/2 x 3/4) mineral interest.

   c. K.S.A. §58-2202 requires that A's intent "to pass a less estate shall expressly appear or be necessarily implied in the terms of the grant."

2. Using the same facts in item 1. above, suppose A excepts from his conveyance to B a 1/2 mineral interest in Section 30. What will A have? A 1/2 or 3/8ths mineral interest? - or perhaps a 1/4th interest? What will B receive? A 1/4th, 3/8ths, or 1/2 mineral interest?
a. Problem is A has failed to designate the source which should be used to calculate the fractional mineral interest reserved to A.

b. Drafting - simple remedy is to state the base fraction from which the excepted or conveyed fraction is to be taken. For example, A could state:

(1) A conveys to B a 1/2 of 3/4ths mineral interest in Section 30. A could also make the same conveyance by giving B a 3/8ths of 8/8ths mineral interest.

(2) A excepts a 1/2 of 8/8ths mineral interest in Section 30.

3. Interpreting Fractional Conveyances.

Although the drafting solution is simple, the process of interpreting inartfully drafted fractional conveyances is difficult. Consider the following case:

In 1985 A conveys Section 30 to B, with A retaining an undivided 1/2 mineral interest; B records the conveyance. In 1986 B conveys, by warranty deed, Section 30 to C "retaining unto B an undivided 1/2 interest in the minerals."

a. B, immediately prior to the conveyance to C, has only an undivided 1/2 interest in the minerals. Will C receive:

(1) No interest in the minerals;

(2) A 1/2 interest; or

(3) A 1/4th (1/2 of B's 1/2) interest?

b. Apparently, the Kansas appellate courts have not addressed this issue.

c. Texas Supreme Court dealt with a similar factual issue in Duhig v. Peavy-Moore Lumber Co., 135 Tex. 503, 144 S.W.2d 878 (1940), which spawned the Duhig Doctrine.

d. Under the Duhig Doctrine C gets a 1/2 mineral interest, leaving B with no mineral interest.

e. In Duhig, since B made a warranty conveyance to C, the court, applying estoppel and
after-acquired title principles, takes from B's excepted 1/2 mineral interest the amount (1/2) required to satisfy the warranted conveyance to C - a 1/2 mineral interest.

f. Commissioner Smedley, applying principles similar to K.S.A. §58-2202, notes: "the language of the deed as a whole does not clearly and plainly disclose the intention of the parties that there be reserved to the grantor Duhig an undivided one-half interest in the minerals in addition to that previously reserved to Gilmer's [A's] estate . . . ." Duhig, 135 Tex at 506-07, 144 S.W.2d at 879.

g. Supporters of Duhig Doctrine - can look at record title and determine who owns what. Duhig attackers - it seldom comports with the intent of the parties; should examine the subjective intent of the parties to determine intent.

h. What if C has knowledge, at the time of the B/C conveyance, of the 1/2 mineral interest previously reserved to A?

(1) K.S.A. §58-2222 (1983) - if properly recorded "all subsequent purchasers . . . shall be deemed to purchase with notice."

(2) Imputing notice to C still does not resolve the ambiguity surrounding B's intent. To determine B's actual intent, you would have to declare the deed ambiguous. On its face, it is not ambiguous.

(3) Should the court, as a matter of law, declare such conveyances ambiguous and allow extrinsic evidence of B's actual intent? Or should the court interpret the conveyance using rules similar to those employed in Duhig and leave B to seek relief through reformation?

IX. AN "OIL AND GAS LEASE" IS NOT A "LEASE"

A. Preliminary Considerations.

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
      obligation to explore and develop the lease.

   558, 563 (1985) (concurring opinion; no such thing as a "standard" oil and gas lease form,
   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 form of oil and gas lease, oil and gas leases create a standard
   relationship. See Pierce, "Rethinking the Oil and Gas Lease," 22 Tulsa Law Journal 445 (1987); See
   generally M. Merrill, Covenants Implied in Oil and Gas Leases §§220-223 (2d ed. 1940); Polston,

   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.

B. 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.
   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 and so long thereafter as oil or gas, or either of them, is produced from the leased land."

(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.

b. 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.
X. CLASSIFYING OIL AND GAS INTERESTS - WHAT COLOR IS THE CHAMELEON?

A. Mineral Interest.


2. 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.

B. Oil and Gas Lease.

1. A "hybrid" property interest.


b. K.S.A. §79-420 does not apply to "leases" (although it was probably intended to do so). Gas Co. v. Neosho County, 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 property interest" and holds: "the legislature has determined oil and gas leasehold interests are to be treated as real property under the statutes pertaining to the recording of 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.

Utica Nat. Bank and Trust Co. v. Marney, 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 Kansas property administration system.

C. Royalty


2. Classified as personal property. Magnusson.

3. However, courts consider the context in which the term "royalty" is used and, when appropriate, interpret references to royalty as an incorrect reference to the mineral interest – real property. In re Estate of Sellens, 7 Kan.App.2d 48, 637 P.2d 483 (1981).
D. Nonoperating Interests - Carved From The Leasehold.

1. Common nonoperating interests:
   a. Overriding Royalty. A right to a share of oil and gas from the leased land free of the cost of production. Payable out of the working interest from which it is carved; will terminate when the lease terminates. *Campbell v. Nako Corporation*, 195 Kan. 66, 402 P.2d 771 (1965).
   c. Net Profits Interest. A right to a share of oil and gas from the leased land free of the cost of production but payable only if and when the lessee earns a net profit from his operations. Difficulty is defining what costs will be deducted from revenues to determine whether a net profit has been realized. *Kumberg v. Kumberg*, 232 Kan. 692, 659 P.2d 823 (1983).
   d. Convertible Interest. A nonoperating interest, such as an overriding royalty, may be convertible to an operating interest after the occurrence of a specified event, such as recovery of costs from a well. Commonly used in farmout transactions.

2. Nonoperating interests carved from the oil and gas lease, and representing the right to share in production when, and if, obtained, are personal property interests. Right to share in production when produced - like a royalty interest. Right created out of an oil and gas lease - a personal property interest.

E. Other Oddities Of Kansas Oil & Gas Law

1. Apportionment of Royalty - Kansas Nonapportionment Rule.

   Suppose A purchases a divided mineral interest in
the West Half of Section 30 when all of Section 30 is subject to an oil and gas lease. A well is subsequently completed as a producer on the East Half of Section 30. Assuming no implied covenant problems, production from the East Half will perpetuate the lease as to all of Section 30.

a. Unless the lease contains an "entireties clause," or special provision is made for apportionment in the conveyance document, A will not receive any royalties from production on the East Half - even though the West Half is subject to the lease. Carlock v. Krug, 151 Kan. 407, 99 P.2d 858 (1940).

b. Apportionment becomes an issue anytime there is a conveyance of a divided interest in minerals which are subject to an oil and gas lease covering the divided interest and other lands.

2. Entirety Clause.

a. To achieve an apportionment of royalties in the event the leased land is subsequently divided into separate tracts, oil and gas leases often contain an entirety clause similar to the following:

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


b. Example: A, owner of Section 30, leases it to X on 1 January 1987. On 2 January 1987 A conveys the SW1/4 to B and the SE1/4 to C. On 1 February 1987 a producing well is drilled on A's retained N1/2 of Section 30.

(1) If the lease does not contain an entirety clause, in Kansas A would receive all the royalty. B and C would receive nothing.

(2) If the lease contains a Brubaker type
entirety clause, royalty would be divided as follows: A 1/2, B 1/4, C 1/4.

3. Rule Against Perpetuities.

a. No interest is good unless it must vest, if at all, not later than twenty-one years after some life in being at the creation of the interest.


b. Must vest within a specified period of time from creation of the interest.

(1) Created by will, clock begins upon testator's death. See generally In re Freeman's Estate, 195 Kan. 190, 404 P.2d 222 (1965).

(2) Created by an inter vivos transaction, clock begins when delivery is complete or the interest otherwise becomes effective. Kenoyer v. Magnolia Petroleum Co., 173 Kan. 183, 186, 245 P.2d 176, 179 (1952).

c. If there is any possibility the interest will not vest within the time required by the rule, it is void. McEwen, 167 Kan. at 124, 204 P.2d at 740.


e. In Kansas a royalty interest vests only when oil or gas is actually produced.

(1) Example: A assigns B a 1/16th royalty interest in oil and gas produced from Section 30.

(2) This grant will not vest until oil or gas is produced from Section 30. Cosgrove v. Young, 230 Kan. 705, 715, 642 P.2d 75, 83 (1982). This is not certain to occur within 21 years from the conveyance so it is void.
f. Same result if A assigns to B one-half the royalty provided for under existing and future oil and gas leases on Section 30. No interest will vest until production. Lathrop, 170 Kan. at 428-29, 227 P.2d at 143-44.

g. My prediction - Kansas Supreme Court will reconsider this rule.

4. Listing Mineral Interests For Taxation.

a. K.S.A. §79-420 (1984) requires severed mineral interests to be recorded or "listed" for taxation. Recording must occur within 90 days after the conveyance is executed or the interest will be deemed void if not listed for taxation.


a. K.S.A. §55-205 (1983) limits the constructive notice effect of a recorded oil and gas lease to its primary term.

b. Most oil and gas leases will terminate unless a contingency in the lease is satisfied - usually production in paying quantities.

c. To maintain the constructive notice provided by the recorded lease, beyond the primary term, the lessee can file an affidavit indicating a contingency required to continue the lease has been satisfied.

d. Since production is the typical contingency, the lessee files what has become known as an "Affidavit of Production."

e. Affidavit must state:

(1) Description of the lease;

(2) Affiant is the owner of the lease; and

(3) Facts showing the required contingency has occurred.

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f. Failure to file an affidavit may result in a third party attaining the status of a bona fide purchaser or encumbrancer (without actual notice of your continued rights) and defeating or subordinating lessee's leasehold interest.


a. Under K.S.A. §§55-1601 et seq. (1983) any "unused" "mineral interest" can be terminated and become vested in the surface owner.


c. Broad definition of "mineral interest" to include "an interest of any kind" in minerals. K.S.A. §55-1601 (1983).

d. Period of continuous nonuse - 20 years.

e. Mineral interest owner can prevent lapse by:
   
   (1) "Using" the interest within the 20 year period.

   (2) Filing a statement of claim to the interest within the twenty-year period.

   (3) Filing a statement of claim within 60 days of the surface owner giving notice of the lapse.

f. Surface owner initiates the process by sending a notice of lapse to the mineral interest owner. If they fail to respond and file a statement of claim within the 60 day period, the interest is "extinguished" and vests in the surface owner. K.S.A. §§ 55-1604 and 55-1605 (1983).

g. Following the lapse procedure will not vest surface owner with marketable title to the lapsed interest. Still must quiet title to give mineral interest owner an opportunity to establish that the interest was "used" and therefore not subject to the Mineral Lapse Act proceeding.

For further information on Kansas oil and gas law, see: D. Pierce, Kansas Oil and Gas Handbook (Kansas Bar Association 1986); available through the Kansas Bar Association.