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Section 1

The Essence of Kansas Oil & Gas Law in 100 Minutes

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CONTINUING LEGAL EDUCATION

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I. BASIC PROPERTY CONCEPTS THAT GOVERN OIL & GAS

A. *Ad coelum* Doctrine

1. Lord Coke's maxim: *Cujus est solum, ejus est usque ad coelum et ad inferos*; translated: "To whomsoever the soil belongs, he owns also to the sky and to the depths." BLACK'S LAW DICTIONARY 341 (5th ed. 1979).

2. Ownership of the surface of land defines ownership above and below the land.

3. Applies to ownership of oil, gas, and all other minerals.

4. Important exception: it does not apply to surface or ground water.

   a. K.S.A. 82a-702. "All water within the state of Kansas is hereby dedicated to the use of the people of the state, subject to the control and regulation of the state in the manner herein prescribed."

   b. K.S.A. 82a-705. "No person shall have the power or authority to acquire a new appropriation right to the use of water for other than domestic use without first obtaining the approval of the chief engineer, and no water rights of any kind may be acquired hereafter solely by adverse use, adverse possession, or by estoppel."

B. The Oil & Gas "Stick"

1. Under American property law it is possible to create just about any division of property imaginable.

2. Traditional limitations: rule against perpetuities and the rule against

unreasonable restraints on alienation.

3. In Kansas freedom of conveyance flourishes, except it is not possible to convey away from the surface the "right to use such land for the production of wind or solar generated energy . . . ." K.S.A. 58-2272.

4. It is possible to create a separate property interest in the oil and gas from the balance of rights in the property.

   a. For example, for a "mineral" estate or interest, the scope of the term "mineral" is defined by the substances identified in the deed.

   b. Must be explicit about the substances being conveyed.

5. K.S.A. 58-2202. "[E]very conveyance of real estate shall pass all the estate of the grantor therein, unless the intent to pass a less estate shall expressly appear or be necessarily implied in the term of the grant."

6. ***O*** conveys to ***A*** "all minerals" in § 30.

   a. We know one thing for sure: ***A*** does *not* own "all minerals" in § 30; ***A*** owns "some" minerals.

   b. ***O*** owns minerals that do no pass to ***A*** under various interpretive tests.

7. Interpretive tests:

   a. K.S.A. § 58-2202. Still useful? *Central Natural Resources, Inc. v. Davis Operating Co.*, 288 Kan. 234, 247, 201 P.3d 680, 689 (2009) ("Given that the deeds expressly tell us that not all of the grantors' estates passed to the grantees, we need not resort to the statutory presumption.").

   b. Surface destruction test. Minerals that require significant destruction to mine are not included in a generic grant of "all minerals."

   c. Community knowledge test. Could the specific mineral have been reasonably contemplated at the time the conveyance was made?

   d. Special varieties test. Is the sand, limestone, etc. "special" or "ordinary"? Special sand is a "mineral" while ordinary sand is not.

   e. Conveyance of "oil, gas, and other minerals" limits the scope of

"other minerals" to minerals that are similar to oil and gas.

(1) *Ejusdem generis* solves the problem at the "oil" and "gas" level.

(2) Does not address what is encompassed by the term "gas."

f. *See* 1 DAVID E. PIERCE, KANSAS OIL AND GAS HANDBOOK 6-4 to 6-9 (1986).

8. ***O*** owns all rights in the property but conveys "all coal" to ***A***. Who owns the methane gas that was created by and found within the coal? *Central Natural Resources, Inc. v. Davis Operating Co.*, 288 Kan. 234, 201 P.3d 680 (2009) (***A*** owns the coal but ***O*** owns all the gas within the coal).

a. Will a similar analysis be applied to a conveyance of shale rock?

b. Will ownership of the shale rock include ownership of gas found within the shale rock?

C. Ownership In-Place of Oil & Gas

1. Classification (unfortunately) plays an important role in defining oil and gas rights. Often rather artificial classifications can have a major impact on a party's rights.

2. Kansas follows the ownership in-place theory for oil and gas meaning that the owner of the mineral has a present possessory interest in the oil and gas.

a. Classified as real property.

b. Cannot be abandoned; have real property remedies.

c. Typically describe it as the oil and gas "in and under" the land.

3. However, ownership can be lost through the rule of capture.

D. Rule of Capture

1. *Ad coelum* doctrine applies to the extent of defining the physical location of the well.

2. Any oil or gas produced from a well properly located, and bottomed, within

surface boundaries, belongs to the owner of the well–even though it has migrated from adjacent lands.

3. Important exception: State well spacing laws may require a set-back from property lines. Note that in Kansas the ***oil*** conservation laws are found at K.S.A. 55-601 to 611 while the ***gas*** conservation laws are found at K.S.A. 55-701 to 713.

   a. K.A.R. 82-3-108(a). "Except as provided by subsection (b) [special rules for shallow oil wells in eastern Kansas] and (c) [exception procedure], an oil well or gas well shall not be drilled nearer than 330 feet from any lease or unit boundary line."

   b. K.A.R. 82-3-109(a). "Any interested party may file an application for, or an application for amendments to, a well spacing or basic proration order."

   c. K.A.R. 82-3-110(a). "Any well drilled or being drilled in violation of an order or rule of the commission in effect at the time drilling commences shall be considered to be an unlawful location. . . ."

   d. K.A.R. 82-3-110(b). "If the commission determines that good cause has not been shown or that an exception should be denied, an order may be issued by the commission requiring the well to be permanently capped or plugged and abandoned . . . or production at a reduced rate may be permitted by the commission to ensure the protection of correlative rights and the prevention of waste."

4. Important exception. In Kansas the set-back rules are supplemented by creating either an "oil drilling unit" or "gas drilling unit" using production limitations to ensure the desired block of acreage is attributable to each well.

   a. Limitations can be based upon special field rules ("prorated pools"), or on a state-wide basis ("non-prorated pools").

   b. OIL: K.A.R. 82-3-203(a). "Well allowables for non-prorated pools. Allowables shall be assigned on an individual well basis. The allowable for each well in nonprorated pools shall be set by the following depth schedule and shall take effect from the date of first production: [0-4000' 100 barrels/day; 4001-6000' 200 barrels/day; below 6000' 300 barrels/day]."

   c. GAS: K.A.R. 82-3-312(a). "Standard daily allowable. The standard

daily allowable for a gas well shall be limited to 50 percent of the well's actual open-flow potential. . . ."

d. OIL: K.A.R. 82-3-207(a). "Standard drilling unit. A standard drilling unit shall be 10 acres. Except as otherwise provided by K.A.R. 82-3-108 (b) or (c), the well for that unit shall be located at least 330 feet from any lease or unit boundary."

e. OIL: K.A.R. 82-3-207(c). "Acreage attributable. When the acreage attributable to any well is less than 10 acres, the well's allowable shall be reduced in the same proportion that the acreage attributable to the well bears to 10 acres."

f. GAS: K.A.R. 82-3-312(c). "Standard daily unit. A standard drilling unit shall be 10 acres. Except as otherwise specified in K.A.R. 82-3-108(c), the well for that unit shall be located at least 330 feet from any lease or unit boundary."

g. GAS: K.A.R. 82-3-312(e). "Acreage attributable. If any gas well is located nearer than 330 feet to any lease or unit boundary line, the standard daily allowable or minimum allowable shall be reduced in the same proportion that the acreage attribution to the well bears to 10 acres."

5. Important exception. K.S.A. 55-1210. Rule of capture modified when dealing with the production of gas that has been injected into an underground storage facility. The injected gas remains the property of the injecting party unless it migrates beyond the storage field boundaries *and* the injecting party is unable to prove, by a preponderance of the evidence, that the gas is injected gas.

6. Pending "pore space" legislation may create another level of complexity by defining rights to the space contained within a rock structure and treating it as a right separate from the rock structure forming the space. *E.g*, WYO. STAT. ANN. § 34-1-152 (2011) (specific statutory requirements to transfer rights in "pore space").

E. Rights Within the Connected Reservoir

1. The most important right of owners within a connected reservoir is the rule of capture. So long as a well is properly located on an owner's land, the production they obtain will belong to that owner–even though it may have migrated from under adjacent lands. The rule of capture recognizes the connected nature of the reservoir.

2. The owners within a connected reservoir also have "correlative rights." These rights exist in two fundamental forms.

   a. First are correlative rights the private owner has against the state of Kansas as the entity (through the Kansas Corporation Commission) that acts to limit the owner's capture rights. Any limitation on a party's capture rights must be administered in a fair manner.

   b. Second are correlative rights the private owner has against other owners in the connected reservoir.

      (1) Traditionally correlative rights have been viewed as a limitation on owners within a reservoir–they cannot do anything that would impair the ability of other owners to exercise their capture rights to develop the oil and gas.

      (2) Conceptually, each owner should have affirmative rights which allow them to use the connected reservoir when it benefits the reservoir community. For example, engaging in hydraulic fracturing even when fissures cross surface boundary lines.

      (3) *See* David E. Pierce, *Developing a Common Law of Hydraulic Fracturing*, 72 U. OF PITTSBURGH L. REV. 685 (2011); David E. Pierce, *Carol Rose Comes to the Oil Patch: Modern Property Analysis Applied to Modern Reservoir Problems*, 19 PENN STATE ENVT'L L. REV. 241 (2011).

3. The KCC defines correlative rights as:

   "[T]he privilege of each owner or producer in a common source of supply to produce from that supply only in a manner or amount that will not have any of the following effects:

   (A) Injure the reservoir to the detriment of others;
   (B) take an undue proportion of the obtainable oil or gas; or
   (C) cause undue drainage between developed leases."

F. Conservation Regulation: Prevention of "Waste" and Protection of "Correlative Rights"

1. Concerned with ensuring the rule of capture is played with designated squares and rectangles of land associated with each well in a reservoir.

a. Avoids a certain level of waste from excessive drilling.

b. Avoids a certain level of damage to correlative rights from excessive drilling.

2. Concerned with ensuring that oil and gas are developed without damage to the environment or an excessive amount of damage to the oil and gas reservoir.

3. Lots of regulation to ensure that surface and groundwater are protected. K.S.A. 55-150 to 55-184. These protections encompass the risks associated with hydraulic fracturing.

4. No mechanism to force landowners within the required minimum block of acreage created by setbacks to pool their interests for development.

   a. No compulsory "pooling" only voluntary pooling either through a pooling clause in the oil and gas lease (exercised using a pooling declaration), or a separate pooling agreement.

   b. For fieldwide development, Kansas provides for compulsory "unitization." K.S.A. 55-1301 to 55-1317.

      (1) Note, however, that K.S.A. 55-1303 allows for unit operation of "a pool *or part thereof*. . . ." (Emphasis added).

      (2) Could the Kansas unitization statute be used as a *de facto* compulsory pooling statute?

      (3) Clearly that was not the intent of the legislature when it adopted the unitization statute.

      (4) Distinguish between the routine combining of acreage to meet set back and spacing requirements (not contemplated by the statutes) vs. unique circumstances where partial pool unitization makes sense.

II. THE OIL & GAS LEASE

For analysis, the oil and gas lease can be viewed as having three categories of operative provisions: (1) the grant, (2) the duration of the grant, and (3) royalty.

A. Rights Granted

1. The first paragraph of the lease lists the basic rights being granted.

   "Lessor . . . hereby grants, leases and lets exclusively unto lessee ***for the purpose of*** investigating, exploring, prospecting, drilling, mining and operating for and producing oil, liquid hydrocarbons, all gases, and their respective constituent products, injecting gas, water, other fluids, and air into subsurface strata, laying pipe lines, storing oil, building tanks, power stations, telephone lines, and other structures and things thereon to produce, save, take care of, treat, manufacture, process, store and transport said oil, liquid hydrocarbons, gases and their respective constituent products and other products manufactured therefrom, and housing and otherwise caring for its employees, the following described land . . . ." **[Granting Clause]**

   a. Texas: conveyance of a defeasible term mineral interest.

   b. Kansas: conveyance of a defeasible term *profit a prendre*.

   c. Pennsylvania: depends on the precise wording of the granting language (a most novel thought).

   d. Alternative granting language: ***Landowner conveys to oil company: "The exclusive right to explore for, develop, and produce oil and gas from the land including title to all oil and gas extracted from the Land."*** [Including appropriate definition of "oil and gas" and grant of rights to use surface and subsurface to exercise the granted rights.]

2. Other portions of the lease also grant various rights.

   a. "Lessee shall have free use of oil, gas, and water from said land, except water from lessor's wells and tanks, for all operations hereunder, including repressuring, pressure maintenance, cycling, and secondary recovery operations . . . ." **[Free Use Clause]**

      (1) Landowner cannot grant right to use water that is subject to appropriation through the State of Kansas.

(2) As to produced water that is "salt water or waters containing minerals of any appreciable degree," K.S.A. 55-901(a) authorizes the operator to "return such waters to any horizon from which such salt waters may have been produced, or to any other horizon which contains or had previously produced salt water or waters containing minerals in an appreciable degree . . . [with KCC approval]."

b. "Lessee shall have the right . . . to remove all property and fixtures placed by lessee on said land, including the right to draw and remove all casing."

c. "There shall be no obligation on the part of the lessee to offset wells on separate tracts into which the land covered by this lease may be hereafter divided by sale, devise, or otherwise, or to furnish separate measuring or receiving tanks."

3. Other portions of the lease also restrict certain granted rights.

a. "When required by lessor, lessee will bury all pipe lines below ordinary plow depth."

b. "Lessee shall pay for damages caused by its operations to growing crops on said lands." **[Crop Damage Clause]**

(1) Can operate as a limitation on liability for surface damages.

(2) Damage compensation limited to damages to growing crops.

c. "No well shall be drilled within two hundred feet (200 ft.) of any residence or barn now on said land without lessor's consent."

d. "Lessor shall have the privilege, at his risk and expense, of using gas from any gas well on said land for stoves and inside lights in the principal dwelling thereon, out of any surplus gas not needed for operations hereunder." **[Free Gas Clause]**

(1) *Schell v. OXY USA Inc.*, No. 07-1258-JTM, 2011 WL 4553091 (D. Kan. Sept. 29, 2011).

(2) Court holds the express terms of the free gas clause, which require the lessee to supply gas for "stoves and inside lights in the principal dwelling," contemplates the lessee will

provide gas of residential-use quality.

(3) Results in a tail-wags-dog outcome where what is generally considered an incidental benefit or privilege is elevated to an overriding duty under the oil and gas lease.

(4) Every lessee providing free gas is now a sort of gas utility with a duty to serve by providing residential-use quality gas.

4. The lease also contains title provisions impacting the granted interests.

a. "together with any reversionary rights and after-acquired interest, therein . . . ."

b. "containing ___ acres, more or less, and all accretion thereto."

c. "The rights of either party hereunder may be assigned in whole or in part and the provisions hereof shall extend to the heirs, executors, administrators, successors, and assigns . . . ." **[Assignment Clause]**

d. "An assignment of this lease, in whole or in part, shall, to the extent of such assignment, relieve and discharge lessee of any obligations hereunder." **[Advance Novation Clause]**

e. "Lessee and lessee's successors and assigns shall have the right at any time to surrender this lease, in whole or in part, to lessor . . . ; thereupon lessee shall be relieved from all obligations, expressed or implied, of this agreement as to the acreage so surrendered . . . ." **[Surrender Clause]**

f. "Lessor hereby warrants and agrees to defend the title to said land, and agrees that lessee, at its option, may discharge any tax, mortgage, or other lien upon said land, and in the event lessee does so, it shall be subrogated to such lien with the right to enforce same and apply rentals and royalties accruing hereunder toward satisfying same." **[Warranty Clause; Subrogation Clause]**

g. "In case said lessor owns a less interest in the above described land than the entire and undivided fee simple estate therein, then the royalties, including substitute gas royalty, and rentals herein provided for shall be paid the said lessor only in the proportion that his interest bears to the whole and undivided fee . . . ." **[Proportionate Reduction Clause/Lesser Interest Clause]**

(1) What is the effect of a proportionate reduction clause on the promised bonus? *Barker v. Boyer*, 794 P.2d 322, 324 (Kan. Ct. App. 1990) ("The specific wording of the lesser interest clause also applied to the *bonus* paid for the execution of a lease and the delay rental paid thereunder.") (emphasis added). The clause in *Barker* stated: "If said Lessor owns a less interest in the above-described land than the entire and undivided fee simple estate therein, then the *royalties and rentals* herein provided shall be paid the Lessor only in the proportion which his interest bears to the whole and undivided fee." *Id.* at 323 (emphasis added). Court cites *Brooks v. Mull* as authority for the bonus *dicta*. Court in *Barker* also states: "It is *universally agreed* that the lesser interest clause acts on the *bonus*, delay rentals, and the lessor's royalty payable under an oil and gas lease." *Id.* at 324. (Emphasis added). Think so?

(2) *Brooks v. Mull*, 78 P.2d 879 (Kan. 1938) (the proportionate reduction clause was identical to the one cited in *Barker*, and expressly applied only to "royalties and rentals"). The court held that the clause would operate against the "down payment" and entitle a later ratifying undivided one-half interest owner to $1,800 of the $3,600 bonus – meaning the party who negotiated the lease for their one-half interest, had the agreed-upon bonus cut in half. As an aside, the court in *Brooks* makes several inaccurate statements of the law: fails to analyze whether the excepted interest was a royalty interest instead of a mineral interest; suggests that a co-tenant in the minerals cannot authorize development without consent of all other co-tenants.

(3) What is the effect of a proportionate reduction clause on an "overriding royalty" retained in the oil and gas lease in addition to the "royalty"?

(4) *Barker v. Boyer*, 794 P.2d 322, 327 (Kan. Ct. App. 1990):

"The reservation in issue herein is not stated to be limited to the oil and gas produced under the terms of this lease nor expanded to all oil produced from the described land, but simply states: 'LESSOR RESERVES A 1/16 OF 7/8 OVERRIDE.'"

Note where this override language is found – in the oil and gas lease. Is it not just an *additional royalty* even though termed an *overriding* royalty?

MOST IMPORTANT THING TO NOTE: The Kansas Supreme Court has not addressed this issue.

(5) Proportionate reduction is often an issue when considering the second tier of document complexity created by assignments to third parties (not the lessor) by the lessee. Assignments also create another level of analysis for all the grant, duration, and royalty issues that can be separately addressed, as between lessee/assignor and the assignee, in assignment documents.

h. "If the leased premises shall hereafter be owned in severalty or in separate tracts, the premises, nevertheless, shall be developed and operated as one lease, and all royalties accruing hereunder shall be treated as an entirety and shall be divided among and paid to such separate owners in the proportion that the acreage owned by each such separate owner bears to the entire leased acreage." **[Entireties Clause]**

(1) If land is subject to an oil and gas lease, and a divided portion of the leased tract is conveyed, the entireties clause becomes critical because Kansas follows the nonapportionment doctrine (discussed below).

(2) If the lease does not contain an entireties clause (and many do not), then whenever a divided portion of a leased tract is conveyed, the conveying instrument should address how apportionment will be handled. Note, however, the duration of the apportionment scheme should last only until the oil and gas lease encumbering the divided interests is in effect. Once it terminates, the parties can make their own individual deals covering their divided interests.

5. Why warranty problems associated with oil and gas are addressed through rules that confer *the interest* on the innocent party instead of damages for breach of warranty covenants.

a. Warranty of title, in the oil and gas context, is often of limited value when production is obtained from the leased land.

b. "[B]asic measure of damages generally adopted for a breach of covenants of warranty in suit by grantee against grantor, is the value of the land *at the time of the conveyance*, which is the consideration agreed upon by the parties, with interest and costs." *Maxwell v. Redd*, 496 P.2d 1320, 1326 (Kan. 1972) (emphasis added).

c. This is why it is so critical that the production attributed to the interest be obtained instead of damages. This is why the *Duhig* doctrine is so important.

6. Kansas has one case that addresses *Duhig*. It is an unreported case that cannot be found using WestLaw. However, it is available on the LexisNexis database: *Grabs v. Dickson*, Case No. 58,991, 1986 Kan. App. LEXIS 1521 and Case No. 58,992, 1986 Kan. App. LEXIS 1524 (Kan. Ct. App. Nov. 13, 1986).

a. Case No. 58,991 concerned the NW1/4. Dickson granted the minerals to Grabs in a warranty deed which stated Dickson owned all rights in the NW1/4. Dickson actually owned an undivided 1/3rd interest in the minerals. Dickson, in the deed, reserved the following:

"In addition, the First Parties [Dickson] reserve unto themselves, their heirs and assigns, a one-sixteenth (1/16) interest in all of the other oil, gas and minerals in and under the above described land for a [specified term]."

b. The court also stated: "It may also be important to note these deeds were all recorded before Grabs bought the NW/4 from Dickson."

c. **O ----------> Dickson**
2/3 1/3

O ----------> Dickson ----------> Grabs
2/3 reserves 1/16 purports to convey 15/16

O ----------> Dickson ----------> Grabs
2/3 0/0 1/3

Applying *Duhig*, because Dickson purported to convey 15/16ths, the remedy is to take Dickson's 1/3rd and give it to Grabs. This still leaves Dickson short by an additional 29/48ths for which Grabs will be limited to a damages claim for breach of warranty.

d. Case No. 58,992 concerned the SW1/4. Dickson granted an undivided one half interest in the SW1/4. Dickson actually owned an undivided 1/3rd interest in the minerals. Dickson, in the deed, reserved "an undivided one-sixteenth (1/16) interest in all of the other oil, gas and minerals . . . ."

e. **O ----------> Dickson**
2/3 1/3

O ----------> Dickson ----------> Grabs
2/3 reserves 1/16 purports to convey 1/2

O ----------> Dickson ----------> Grabs
2/3 0/0 1/3

f. The court adopted *Duhig* noting:

"Apparently the *Duhig* rule has never been considered in Kansas. The rule appears logical, however, and provides a method of construing all such deed[s] consistently. An old Kansas case provides some support for applying the rule here. In *Batterton v. Smith, 3 Kan. App. 419, 421, 43 Pac. 275 (1896)*, the court held a grantee's knowledge of title defects did not prevent his recovery from his grantor for breach of warranty based on the title defects."

"Dickson warranted he was conveying all the mineral but reserved 1/16. Based on our conclusion that he owned on[ly] 1/3, he, therefore, breached his warranty to convey 15/16 of the minerals and should now be estopped to assert any claim that he reserved any interest. Unlike *Duhig*, furthermore, even this resolution does not prevent his breach of warranty–he still failed to transfer (15/16 - 1/3) or 29/48 to Grabs."

7. How about K.S.A. 58-2202: "[E]very conveyance of real estate shall pass all the estate of the grantor therein, *unless the intent to pass a less estate shall expressly appear or be necessarily implied in the terms of the grant.*" (Emphasis added).

B. Duration of the Rights Granted

1. "Subject to the provisions herein contained, this lease shall remain in force for a term of ten (10) years from this date (called 'primary term'), ***and as long thereafter as*** oil, liquid hydrocarbons, gas or other respective

constituent products, or any of them, ***is produced from said land*** or land with which said land is pooled." **[Habendum Clause]**

a. "Produced" means produced in "paying quantities."

b. What are "paying quantities"?

c. ***Claiborne v. Galemore***, No. 103,163, 2010 WL 5490736 (Kan. Ct. App. Dec. 23, 2010) (unpublished opinion).

(1) The Claibornes, sent notice to their oil and gas lessee, Galemore Oil, demanding that Galemore file a release of its lease, contending the lease had terminated for failure to produce in paying quantities. Galemore refused claiming the lease was still in effect.

(2) The Claibornes used expert testimony to establish the time a prudent operator would spend on the lease, the cost of plugging abandoned wells, and other actions a prudent operator would take to maintain the lease.

(3) Galemore's expert offered some of the most damning testimony indicating a prudent operator would have devoted a minimum of 2 hours per day, 7 days a week, to operate the lease.

(4) This was considerably more time than the 4.5 hours per week Galemore estimated he and his son devoted to the lease.

(5) The accounting period: May 2003 to August 7, 2006

(6) Period during which lease revenue and expenses would be compared.

(7) In Kansas the selection of the accounting period for comparing revenue and expenses is critical because, as the court notes, the continuing life of the lease "is a straightforward profit and loss mathematical computation." *Id.* at *6.

(8) The time frame selected for the accounting period should reflect an appropriate period of time a prudent operator would require to evaluate the performance of the lease.

(9) Attributed Expenses: The Kansas approach to paying quantities considers actual expenses, but also expenses that may not have been incurred or documented, but which *should have been* incurred if the lessee were acting as a prudent operator.

(10) The trial court attributed 14 hours per week to labor in maintaining the lease, added 7 hours per week in travel time to and from the lease, added fuel costs to travel to and from the lease, and held that operating costs should have included the costs of plugging newly discovered abandoned wells that had "erupted" on the lease.

(11) These items added over $32,000 to the expenses identified by Galemore and exceeded production revenue, thereby causing the lease to terminate for failure to produce in paying quantities.

2. "[I]f there is a gas well or wells on the above land (and for the purposes of this clause the term 'gas well' shall include wells capable of producing natural gas, condensate, distillate or any gaseous substance and wells classified as gas wells by any governmental authority) and such well or wells are shut in before or after production therefrom, lessee or any assignee hereunder ***may pay or tender*** annually at the end of each yearly period during which such gas well or gas wells are shut in, as substitute gas royalty, a sum equal to the amount of delay rentals provided for in this lease . . . and ***if such payments or tenders are made*** it shall be considered under all provisions of this lease that gas is being produced from the leased premises in paying quantities." **[Shut-In Royalty Clause]**

a. *Levin v. MAW Oil & Gas, LLC*, 234 P.3d 805 (Kan. 2010).

Lessee MAW drilled coalbed methane wells and paid shut-in royalty to its lessors.

(1) Apparently at the time the shut-in royalty was paid dewatering operations on the wells had not commenced.

(2) The lessors sought to quiet title against MAW asserting its oil and gas leases had terminated because its wells were not capable of producing in paying quantities, and therefore could not rely upon the shut-in royalty clause.

(3) The trial court granted summary judgment to the lessors. MAW appealed.

(4) Supreme court reversed and remanded to develop and evaluate the facts surrounding the wells in light of its opinion.

b. Court analyzes case law noting that "capable" of producing does not mean it can, in fact, produce.

(1) Cases where there is no pipeline connection.

(2) Cases where there is "no" market.

(3) Cases where there is a crappy market. See comments about *Tucker* below.

c. Court rejects any sort of bright-line test for when a well qualifies as a shut-in well (absent specific lease language) by being sufficiently complete to be deemed capable of producing.

(1) Important that the court declines "lessors' invitation to adopt a rigid legal definition of shut-in entirely dependent upon *whether dewatering has begun or upon whether equipment or repairs are still needed.*"

(2) The court continued, noting:

> "[F]actors to be considered by the fact finder in determining whether a well is physically complete and capable of producing in paying quantities, i.e., shut-in, are those that affect the properties and potential of the well itself, rather than the likely success of any processing or transport of product that remains to be attempted or accomplished."

d. It is an issue of fact, appropriate for expert testimony, to determine "whether the subject wells were physically complete and capable of producing in paying quantities."

e. The court deals a well-deserved blow to the holding in *Tucker v. Hugoton Energy Corporation*, 855 P.2d 929 (Kan. 1993), which held that if a market, any market ("limited" market), is available for gas from the wells at issue, the shut-in royalty clause cannot be relied upon.

"Although *Tucker* asserts that the total absence of a market for natural gas is a prerequisite to classify a well as shut-in and thus bring into play a shut-in royalty clause, this assertion appears to arise out of an over interpretation of *Pray* and insufficient attention to the subject lessees' language. . . . ***In other words, Pray did not make the absence of a market a part of Kansas' definition of 'shut-in.***'"

3. "If ***operations for drilling are not commenced*** on said land or on land pooled therewith on or before one (1) year from this date, this lease shall terminate as to both parties, unless on or before one (1) year from this date lessee shall ***pay or tender to the lessor a rental*** of ____ Dollars which shall cover the privilege of deferring commencement of such operations for a period of twelve (12) months. . . ." **[Drilling, Delay Rental Clause]**

   a. What are "operations for drilling"? Are they different from "drilling operations"? When are they commenced?

   b. When do you commence to bake a cake? When you mix the ingredients together? Or, when you put it in the oven?

   c. In Kansas, anything less than actual drilling, with a rig capable of drilling to the targeted depth shown in a drilling permit, is risky.

      (1) *Hall v. JFW, Inc.*, 893 P.2d 837 (Kan. Ct. App. 1995), *rev. denied.*

      (2) *Herl v. Legleiter*, 668 P.2d 200 (Kan. Ct. App. 1983).

      (3) *Bunnell Farms Co. v. Samuel Gray, Jr. & Associates*, 47 P.3d 804 (Kan. Ct. App. 2002).

      (4) *A & M Oil, Inc. v. Miller*, 715 P.2d 1295 (Kan. Ct. App. 1986) (commence drilling on off-lease tract to directionally drill into leased tract).

      (5) MOST IMPORTANT THING TO NOTE: The Kansas Supreme Court has not addressed this issue.

4. "If prior to the discovery of oil, liquid hydrocarbons, gas or their respective constituent products, or any of them, on said land or land pooled therewith lessee should ***drill and abandon a dry hole*** or holes thereon, or if, after discovery of oil, liquid hydrocarbons, gas or their respective constituent products, or any of them, the ***production thereof should cease from any***

cause, this lease shall not terminate if lessee ***commences reworking or additional drilling operations*** within sixty (60) days thereafter, ***or*** **(if it be within the primary term)**, (i) ***in the case of a dry hole***, commences or resumes the payment or tender of rentals or commences operations for drilling or reworking on or before the rental paying date occurring twelve (12) months after the expiration of the rental period during which such dry hole was drilled, or (ii) ***in the case of cessation of production***, commences or resumes the payment or tender of rentals or commences operations for drilling or reworking on or before the rental paying date next ensuing after the expiration of three (3) months from the cessation of production. **[Dry Hole Clause; Cessation of Production Clause]**

a. Will the cessation clause replace the cessation doctrine? "Cease from *any* cause"?

b. *Welsch v. Trivestco Energy Co.*, 221 P.3d 609 (Kan. Ct. App. 2009).

Lessee, Trivestco, shut in a gas well when its gas purchaser ceased making payments for gas and went into bankruptcy. The well was shut in for 2½ years during which no shut-in payments were tendered nor other action taken to remedy the lack of production.

Landowner Welsch demanded a release. Parties ended up in court with Welsch asserting the lease terminated under the habendum clause for failure to produce.

The trial court held it would be unfair to have Trivestco lose its lease. Trivestco was ordered to pay Welsch for unpaid shut-in royalty, alternatively the cessation in production was a temporary cessation and also protected by the force majeure clause. So – that would mean no shut-in royalty would be due?

c. Court of appeals reverses holding the lease terminated for non-payment of shut-in royalty and neither the cessation clause nor the force majeure clause apply.

d. **Habendum clause:** "term of three (3) years from this date (called the 'primary term') and as long thereafter as oil, liquid hydrocarbons, gas or other respective constituent products, or any of them, is produced from said land or land with which said land is pooled."

e. **Shut-in Roylaty Clause:** "at any time either before or after the expiration of the primary term of this lease, ***if there is a gas well*** or

wells on the above land . . . ***and such well or wells are shut in*** before or after production therefrom, lessee . . . ***may pay*** or tender annually at the end of each yearly period during which such gas well or gas wells are shut in, as substitute gas royalty, a sum equal to the amount of delay rentals provided for in this lease . . . and ***if such payments or tenders are made*** it ***shall be considered under all provisions of this lease that gas is being produced from the leased premises in paying quantities***."

f. There was a gas well, the gas well was shut in, but lessee failed to make shut-in royalty payments.

(1) Could the lessee be sued for failure to make the payments? No, they were optional and nothing indicated the option had been exercised.

(2) What if the lessee really wanted to make the payments, but failed to do so?

g. Classic condition vs. covenant analysis.

(1) The language "may pay" and "if" the payment is made the lease will continue.

(2) No obligation to pay, and failure to pay does not result in the conclusion, for habendum clause purposes, that gas is being produced in paying quantities.

(3) This is a condition, not a covenant.

h. No obligation to pay, no payment, no resulting satisfaction of the habendum clause, lease terminates for lack of production.

i. **Cessation Clause:** "If , . . . after discovery of oil, liquid hydrocarbons, gas or their respective constituent products, or any of them, the ***production*** thereof should ***cease*** from ***any cause***, this lease shall not terminate if lessee commences reworking or additional drilling operations within sixty (60) days thereafter. . . ."

(1) Court holds lessee cannot rely upon the temporary cessation doctrine because the parties' rights in the event of a cessation "from any cause" are addressed by the cessation clause.

(2) No action taken within the 60-day time frame to commence "reworking or additional drilling."

(3) NOTE: if, as the court holds, the cessation clause replaces the temporary cessation doctrine, then the term "reworking" will need to be interpreted broadly. Otherwise, you could have cessations caused by events that do not require (or permit) additional drilling to solve but could extend beyond the 60-day grace period.

(4) The court seems to assume that the only thing you can do within the 60-day time frame is "reworking" or "additional drilling."

(5) So, does this mean that something that causes a cessation that does not require "reworking" or "additional drilling," such as full oil tanks and no available crude oil purchaser, means the lease terminates?

(6) Or, does it mean that you must respond, within 60 days, to fix the problem – even though it may not require commencement of "reworking or additional drilling operations"?

(7) The court's interpretation, excluding any temporary cessation doctrine considerations, means the full universe of events that can interrupt production(event those not technically within the scope of "reworking" or "additional drilling"), must somehow be accounted for.

(8) One way to do it is give the term "reworking" the broadest possible definition such as: anything a lessee would do to respond to a cessation of production from a lease.

5. "If, at the expiration of the primary term, oil, liquid hydrocarbons, gas or their constituent products, or any of them, is not being produced on said land or land pooled therewith ***but lessee is then engaged in operations for the drilling or reworking or any well thereon***, this lease shall remain in force so long as drilling or reworking operations are prosecuted (whether on the same or different wells) with no cessation of more than sixty (60) consecutive days, and if they result in production, so long thereafter as oil, liquid hydrocarbons, gas or their respective constituent products, or any of them, is produced from land or land pooled therewith." [**Operations/Completion Clause**]

a. Same sort of "commencement" issues as noted above.

b. What is the scope of "reworking"?

c. Should there be a category of action other than "drilling" or "reworking"?

6. "Lessee shall not be liable for delays or defaults in its performance of any agreement or covenant hereunder due to force majeure. . . ." **[Force Majeure Clause]**

a. New York Marcellus moratorium.

b. Clause must be carefully crafted to address issues that would otherwise fall into an "impracticability" analysis – but we never get to consider such excuses because of the special limitation context in which the clause operates. The lessee is not so concerned about being relieved from a breach of a "covenant" but rather from a "condition" or "special limitation" to the continuing life of the lease.

c. *Welsch v. Trivestco Energy Co.*, 221 P.3d 609 (Kan. Ct. App. 2009).

Force Majeure Clause: "Lessee shall not be ***liable for*** delays or defaults in its ***performance of any agreement or covenant*** hereunder due to force majeure. The term 'force majeure' as employed herein shall mean: any act of God . . . ; exhaustion or unavailability or delays in delivery of any product, labor, service, or material."

(1) The court holds this clause did not apply because nothing prevented the lessee from paying the shut-in royalty.

(2) This assumes the force majeure clause cannot be an independent basis for excusing performance. What if this were an "oil" well where the option to pay shut-in royalty does not exist?

(3) The court misses the more fundamental analysis to reject the lessee's force majeure claims: the clause only applies to covenants – not conditions. The court needs to apply the same covenant/condition analysis to this clause that it applied to the shut-in royalty clause.

C. Landowner Compensation

1. In addition to compensation through the up front payment of cash to induce the mineral owner to enter into a lease – the "**bonus**" – lessors will receive **delay rental** (unless they are entering into a "paid up" lease), and, if there is production, **royalty**.

    a. Issue regarding the paid up lease: does it expressly negate the implied covenant to test during the primary term?

    b. Merely removing the delay rental clause will resurrect the implied covenant to drill a test well within a reasonable period of time – unless expressly negated.

2. "The royalties to be paid by lessee are: (a) on oil, and other liquid hydrocarbons saved at the well, ***one-eighth of that produced*** and saved from said land, ***same to be delivered*** free of cost at the wells or to the credit of lessor in the pipe line to which the wells may be connected; **[Oil Royalty Clause]**

3. "(b) on gas, including casinghead gas and all gaseous substances, produced from said land and sold or used off the leased premises or in the manufacture of gasoline or other products therefrom, the ***market value at the mouth of the well*** of one-eighth of the gas so sold or used, provided that on gas ***sold at the wells the royalty shall be one-eighth of the amount realized*** from such sale . . . ." **[Gas Royalty Clause]**

4. The major dispute regarding royalty: at what *location* can or must the lessee do something with the extracted oil or gas?

    a. Oil: deliver "*at the wells* or to the credit of lessor in the pipe line to which the wells may be connected."

    b. Gas: which market value should be used to calculate royalty? "Market value *at the mouth of the well*"?

    c. Gas: can you sell the gas "at the well" and then use the amount realized from the wellhead sale to calculate royalty? "[O]n gas sold at the wells the royalty shall be one-eighth of the amount realized."

    d. Disclosure Note: I am an expert witness for oil and gas lessees currently litigating this and other royalty issues.

D. Lessor Leasing Considerations

1. Is it time to lease?

    a. Risks associated with waiting to lease.

    b. Risks associated with leasing too soon. Most favored nations clause?

2. When the landowner decides to lease.

    a. Granting Clause: whatever is granted should contract to the smallest unit necessary to operate the parts of the lease that are actually developed by the end of the primary term.

    b. Two dimensions: vertical and horizontal.

    c. Problems with floating easements. Ensure the lessor is not limited in prospective use of the land – at least until the lessee actually occupies an area not already occupied by the lessor.

    d. Surface disruption compensation.

    e. Surface use limitations.

3. Habendum clause. Once you decide to lease, you want development as soon as possible – as much as possible. Use it or lose it.

4. Royalty clause. Objective and easy to police.

E. Lessee Leasing Considerations

1. Granting Clause: minimum area necessary to conduct the anticipated development. Pooling to assemble the minimum block of acreage. Easements to support operations in the area or on adjacent lands.

2. Habendum Clause: reasonable period to conduct development and maintain the lease even when production is disrupted. Well-defined guidance as to when a well is "commenced," "completed," when "operations" are in progress, the scope of "work over" and similar duration defining terms such as "shut-in" and "dry hole."

3. Scope of authority to prudently pursue operational activities required to maximize production from the leased land.

4. Royalty clause. Objective and easy to comply with.

F. Easements Associated With Oil & Gas Development

1. The easement rights created in a mineral interest owner, or in an oil and gas lessee, are typically "floating" or "blanket" easements in the entire tract of land conveyed or leased.

2. Guidance from the ***Restatement (Third) of Servitudes***.

   a. **§ 1.1(2)(c)**. Profits for the removal of oil, gas, and minerals "not within the scope of this Restatement" – "[t]o the extent that special rules and consideration apply" to them.

   b. **Comment e**. "To the extent that special rules and considerations ***do not apply*** to profits and mortgage and lease covenants, the rules and principles set forth in this Restatement may be applied."

   c. General principles to assist in defining rights in easements in all contexts.

III. CONVEYANCING ISSUES

A. Title to Minerals

1. **Marketable Record Title Act**, K.S.A. §§ 58-3401 to 58-3412. Of limited assistance (until a mineral interest is severed from the balance of rights in the property). Interests ***not*** subject to the Act's provisions:

   a. § 58-3408(b): "rights . . . to **any lease** of any lessee or any lessee's successor."

   b. § 58-3408(d): "**any mineral interest** which has been severed from the fee simple title of the land."

   c. § 58-3408(e): "any easement or interest in the nature of an easement, or any rights granted, reserved or excepted by any instrument creating such an easement or interest."

   d. § 58-3408(f): "use restrictions."

   e. § 58-3408(g) & (h): rights in a future interest (reversionary interests and remainders). What about executory interests?

2. **K.S.A. § 79-420.** A vicious statute designed to ensure severed mineral interests are listed for taxation by deeming the conveyance void if not timely recorded.

   a. "Whenever the fee to the surface . . . is in any person . . . and the right or title to any minerals therein is in another . . . such mineral shall be listed . . . separately from the fee . . . . When such reserves or leases are not recorded within 90 days after execution, they shall become void if not listed for taxation."

   b. There is an extensive, and sometimes surprising, body of common law interpreting this statute. *See* 1 DAVID E. PIERCE, KANSAS OIL AND GAS HANDBOOK 5-10 to 5-13 (1986).

3. **Mineral vs. Royalty.** Kansas law, as a practical matter, requires the owner of a severed interest in oil and gas to determine whether they own a "mineral" or a "royalty" interest.

   a. **Mineral Interest**: right to oil and gas "in place." Classic language is conveyance of oil and gas "in and under" the land.

   b. **Royalty Interest**: right to oil and gas as it is extracted. Classic language is conveyance of oil and gas "produced" from the land.

   c. Reasons why it matters:

      (1) Mineral interest deemed to vest immediately and does not violate the Rule Against Perpetuities.

      (2) Royalty interest not subject to K.S.A. § 79-420.

      (3) Mineral interest includes development rights and corresponding right to lease.

      (4) Royalty interest is a passive income interest.

      (5) Fractional "royalty" interest typically yields 8 times the production revenue as compared to a fractional "mineral" interest.

   d. Mineral interests can be "nonparticipating" in one or more of the mineral attributes or benefits under an oil and gas lease.

(1) The right to lease or develop oil and gas that is part of a mineral interest can be severed from the mineral interest.

(2) Benefits under an oil and gas lease can be severed from the mineral interest.

(3) For example, ***O*** conveys to ***A*** an undivided 50% of the oil and gas in and under § 30 [legal description] but excepting and retaining in ***O*** the right to lease and develop the oil and gas conveyed to ***A*** together with the right of ***O*** to retain for himself all bonus and delay rental associated with any oil and gas lease covering ***A***'s nonparticipating mineral interest.

(a) ***A*** in the above example has a nonparticipating mineral interest that participates only in royalty attributable to ***A***'s 50% mineral interest.

(b) Assume ***O*** enters into an oil and gas lease covering ***O***'s 50%, plus ***A***'s 50%; the lease provides for a $10,000 bonus, $640/year delay rental, and a 1/8th royalty (and assume the 1/8th royalty is the maximum ***O*** could have negotiated for). ***O*** is entitled to all the bonus, all the delay rental, and 50% of the royalty; ***A*** is entitled to 50% of the royalty.

4. Rule Against Perpetuities.

a. The Kansas Supreme Court has held that creation of a perpetual royalty interest violates the Rule Against Perpetuities (the "Rule").

b. For example: ***O*** conveys to ***A*** 1/16th of all the oil and gas produced from § 30.

(1) This is treated as a non-vested interest because the court has defined the vesting event as "production."

(2) At the date of the grant it cannot be said with certainty that there will be production from § 30 within a life or lives in being plus 21 years.

(3) Violates the Rule so ***A***'s interest is void. ***A*** owns nothing.

c. A mineral interest is deemed by the court to vest upon delivery of the

deed.

(1) Note, just like a royalty interest, we don't know if there will ever be production from § 30. But the royalty interest is void and the mineral interest is valid.

(2) Note also that a nonparticipating mineral interest, that participates in nothing but royalty, is nevertheless deemed to vest immediately and not subject to the Rule.

d. The Rule in this context is being examined again in *Rucker v. DeLay*, 44 Kan. App.2d 268, 235 P.3d 566 (2010). The Kansas Supreme Court accepted review of the case and heard oral arguments on September 28, 2011.

e. Uniform Statutory Rule Against Perpetuities

(1) The "new" rules apply to transactions entered into on or after July 1, 1992 – primarily the exemption of "nondonative transfers" (K.S.A. § 59-3404(1)), the 90-year wait-and-see provision (K.S.A. § 59-3401(a)(2)), and the reformation provision (K.S.A. § 59-3403).

(2) Important section that has retroactive effect (to help with all pre-July 1, 1992 transactions): K.S.A. § 59-3405(b).

(3) But, are these statutes part of a bill containing multiple subjects that violates article 2, § 16 of the Kansas Constitution – and is void? *See* David E. Pierce, *Void Enactments of the Kansas Legislature*, 80 J. KAN. B. ASS'N 28 (July/Aug. 2011).

5. Adverse Possession.

a. Many title problems are resolved by adverse possession. But problems associated with a previously-severed mineral interest will not be impacted by surface use.

b. Once a mineral interest is severed from the surface, entry by an adverse possessor of the surface will not impact the severed mineral interest.

c. Use of the previously severed surface interest does not create a cause

of action that can be asserted by the mineral interest owner.

(1) Occupancy by an adverse possessor of a house, farming the land, etc. are not acts adverse to a severed mineral interest owner.

(2) Must be some direct activity that invades the mineral interest so as to give rise to a cause of action and at the same time provides notice to the world that an interest other than the surface is being claimed.

d. *Mining Co. v. Atkinson*, 85 Kan. 357, 360, 116 P. 499, 50 (1911). *See* 1 DAVID E. PIERCE, KANSAS OIL AND GAS HANDBOOK 8-17 to 8-21 (1986).

B. Easements by Necessity

1. Severed Mineral Interest. ***O*** conveys to ***A*** the oil and gas in § 30. If the deed contains no further language addressing the scope of ***A***'s mineral rights, ***A***'s rights include the right to make reasonable use of the surface to extract the oil and gas.

2. Oil and Gas Lessee. Although oil and gas leases typically contain express provisions – easements – to use the surface to support oil and gas operations, if the lease were silent on the matter the lessee would nevertheless enjoy an implied right to make reasonable use of the surface.

3. Obligation to Pay Damages Associated with Reasonable Use?

a. Severed mineral interest: no case on point. General easement by necessity law does not require payment for use of the land within the confines of the recognized easement.

b. Oil and gas lease: crop damage cases. Obligated to pay only when the damage comes within the definition of "crop damages."

c. *See* 1 DAVID E. PIERCE, KANSAS OIL AND GAS HANDBOOK 12-9 to 12-14 (1986).

C. Conflicts Among Competing Land Users

1. Farm Tenants.

   a. What is the intended scope of a farm lease? Does it anticipate that during the term of the lease the owner of the land cannot develop its mineral potential?

   b. Minerals severed, or oil and gas lease granted, prior to the farm lease: farm tenant subject to the terms of the severed mineral owner's right to make reasonable use of the surface (assuming no limitations expressed in the deed creating the mineral interest).

2. Wind Tenants.

   a. Who was first? Severed mineral interest, oil and gas lessee, wind lessee?

   b. Ability to co-exist using the same tract of land?

3. Water Use. Hydraulic fracturing; secondary recovery.

IV. SPECIAL ISSUES WHEN TRANSACTING IN PROPERTY UNDER LEASE

A. What Does the Landowner *Own*?

1. Traditionally landowners often misconceive what they "own" when their mineral interest is subject to an oil and gas lease.

2. Often mix-up not only the nature of the interest ("royalty" as opposed to "mineral"), but also the fraction of ownership ("1/8th" as opposed to "8/8ths").

3. Can have unique situation where a conveyance of a "1/8th royalty interest" is intended to convey an "8/8ths mineral interest."

4. *Heyen v. Hartnett*, 235 Kan. 117, 679 P.2d 1152 (1984) (1/16th mineral interest intended to convey ½ the minerals).

B. Nonapportionment Doctrine

1. 2005: ***O*** enters into oil and gas lease with ***X*** covering all of § 30 with a primary term of 3 years and a 1/8th royalty.

2. 2006: ***O*** conveys to ***A*** the NW1/4 of the NW1/4 of § 30.

   a. ***X*** drills a well on the NW1/4 of the NW1/4.

   b. How will royalty under the lease be divided?

   c. Nonapportionment doctrine: ***A*** receives all the royalty; ***O*** gets nothing.

   d. Does the lease have an "entireties clause"? If so, the effect will be to give ***A*** 40/640 x 1/8th and ***O*** 600/640 x 1/8th.

   e. Does the deed creating the divided interest in ***A*** address the issue? Rarely.

3. *See* 1 DAVID E. PIERCE, KANSAS OIL AND GAS HANDBOOK 6-30 to 6-31 (1986).

PROPERTY EXAMINATION
QUESTION #1

As of May 26, 2005 Livi Louise owned Section 24, Township 11 South, Range 15 East of the 6th Principal Meridian, Shawnee County, Kansas. The relevant documents in the chain of title to this land are as follows:

DEED

Livi Louise, a single woman, conveys and warrants to Robert Riley for life, remainder to Mark Allai, an undivided one half interest in the South Half of Section 24, Township 11 South, Range 15 East of the 6th Principal Meridian, in Shawnee County, Kansas.

Signed this 10th day of September 2005.

DEED

Livi Louise, a single woman, conveys and warrants to Cheryl Stice an undivided one half interest in the South Half of Section 24, Township 11 South, Range 15 East of the 6th Principal Meridian, in Shawnee County, Kansas.

Signed this 15th day of September 2005.

On October 10, 2007 Cheryl entered into an oil and gas lease with Acme Oil Company which leases "the undivided one-half interest Cheryl Stice owns in the South Half of Section 24, Township 11 South, Range 15 East of the 6th

Principal Meridian, in Shawnee County, Kansas." The oil and gas lease authorizes Acme to enter the South Half of Section 24 and explore for, extract, and remove oil and gas from the South Half of Section 24. The lease obligates Acme to pay Cheryl a royalty equal to 1/8th of the current market value, at the time of extraction, of all oil and gas produced from the land, to be proportionately reduced to reflect Cheryl's actual ownership in the oil and gas (1/8 x Cheryl's ½ interest = 1/16th royalty). The lease expressly authorizes Acme to enter the surface of the leased land to conduct all necessary oil and gas development operations.

On November 1, 2007 Acme moved onto the South Half of Section 24 and completed an oil well that is producing 100 barrels of oil each day. The reasonable cost of drilling and operating the well to date is $1,500,000.00. To date Acme has sold 3400 barrels of oil at an average price of $87/barrel resulting in $295,800 in revenue. Acme immediately paid Cheryl $18,487.50 for her share of the production due pursuant to her oil and gas lease ($295,800 x 1/16). Acme has paid nothing to Robert or Mark but has merely sent them the following letter:

ACME OIL COMPANY
1542 Crosscoach Lane
Katy, Texas 77651

December 4, 2007

Robert Riley
[correct address]

Mark Allai
[correct address]

Re: Production of Oil from the South Half of Section 24, Township 11 South, Range 15 East of the 6th Principal Meridian, in Shawnee County, Kansas

Dear Mr. Riley and Mr. Allai:

Pursuant to an Oil and Gas Lease from Cheryl Stice, who owns an undivided one half interest in the South Half of Section 24, Acme Oil Company has completed a producing oil well on this land and to date have removed and sold 3400 barrels of oil, for a total sales price of $295,800.00 The reasonable cost of drilling and operating this well to date is $1,500,000.00. As owners of the other one-half of the oil and gas in this land you are entitled to one-half of the net proceeds from development. Therefore, once we have recovered all of our costs ($1,500,000.00), we will begin distributing your share of the proceeds, net of current operating costs.

This means you will not receive any money from the oil we are removing and selling from the land unless, and until, we recover another $1,204,200.00 in production revenue from the sale of oil.

I will keep you apprised, on a monthly basis, of the status of your account and the payout status of our well. Let me know if you have any questions.

Sincerely,

Acme Oil Company
[Signed by Mark]

_____
By: Mark Loy, President

Robert and Mark, while talking with Cheryl, learned that she had received over $18,000 for oil removed from her land. Robert and Mark file suit against Acme.

QUESTION #1

Under the facts you have been given, which of the following statements are correct?

A. The actions of Cheryl and Acme constitute waste as against Robert.

B. The actions of Cheryl and Acme constitute waste as against Mark.

C. The actions of Acme constitute waste as against Robert and Mark.

D. In the event Acme does not realize a net profit from its well, it will be required to pay Robert and Mark a reasonable royalty to be divided between them as the law requires.

E. Acme's actions in sending the letter are consistent with the requirements of the Statute of Anne.

F. It is not possible for Acme to remove the oil and gas from the South Half unless it has the consent of both the life tenant and the remainder interests.

G. A. & B.

H. A., B., & F.

The Essence of Kansas Oil & Gas Law

(In 100 Minutes)

David E. Pierce
Washburn Law School

1

Basic Property Concepts

- Surface boundaries define the extent of subsurface ownership.
- Owner of the surface owns all the oil, gas, and other minerals beneath the surface.
- Exception: Water belongs to the State of Kansas.

2

Basic Property Concepts

- American property law: create whatever property interest you can describe.
- Limitations are minimal: rule against perpetuities; rule against unreasonable restraints on alienation.
- Cannot separate from surface the "right to use land for the production of wind or solar generated energy." **K.S.A. 58-2272**.

3

Basic Property Concepts

- **K.S.A. 58-2202**. "[E]very conveyance of real estate shall pass all the estate of the grantor therein, unless the intent to pass a less estate shall expressly appear or be necessarily implied in the term of the grant."
- Can convey and own minerals separate from the balance of the property.

4

Basic Property Concepts

- ***O*** conveys to ***A*** "all minerals" in § 30.
- We know one thing for sure:
- ***A*** does ***not*** own "all minerals" in § 30.
- ***A*** owns ***some*** minerals; ***O*** still owns some minerals.

5

Basic Property Concepts

- **Interpretive Tests:**
- **58-2202** (interpret against grantor)
- **Surface Destruction Test**.
- **Community Knowledge Test**.
- **Special Varieties Test**.
- ***Ejusdem generis*** (oil, gas, and other minerals).

6

Basic Property Concepts

- Who owns coalbed methane gas when the coal has been conveyed away?
- ***O*** owns all rights in the property but conveys "all coal" to ***A***.
- ***Central Natural Resources, Inc. v. Davis Operating Co.***, 201 P.3d 680 (Kan. 2009) (***A*** owns the coal but ***O*** owns all the gas within the coal).

7

Basic Property Concepts

- Who owns oil or gas within a separately-conveyed [shale] formation?
- Who owns the pore space within a separately-conveyed [shale] formation?

8

Basic Property Concepts

- Conveyance of the oil and gas in a tract of land transfers the oil and gas in-place.
- Present possessory interest (corporeal hereditament), even though it may be lost under the Rule of Capture.
- Real property.

9

Basic Property Concepts

- **Rule of Capture**
- Surface boundaries used to define the basic ground rules for playing the capture game.
- You own all oil and gas extracted through a well located within the surface boundaries of your land.

10

Basic Property Concepts

- **Limits on the Rule of Capture:**
- **Spacing regulation** (statewide rule): 330' set-back (subject to some exceptions).
- **Production regulation** (statewide rule): 10-acre production unit for full allowable.
- Field rules will govern over statewide rule.
- **K.S.A. 55-1210**. Produced gas injected into gas storage reservoir.

11

Basic Property Concepts

- **Correlative Rights.**
- Recognize that owners in a common reservoir do not own a compartmentalized portion of the reservoir that is isolated from all other owners.
- They are connected.
- Creates duties to others, and rights in the reservoir (in addition to your portion).

12

Basic Property Concepts

- "[T]he privilege of each owner or producer in a common source of supply to produce from that supply only in a manner or amount that will not have any of the following effects: **(A)** Injure the reservoir to the detriment of others; **(B)** take an undue proportion of the obtainable oil or gas; or **(C)** cause undue drainage between developed leases." **K.A.R. 82-3-101(21).**

13

Basic Property Concepts

- **Conservation Regulation**
- Must play the capture game using squares and rectangles.
- Spacing (set-backs).
- Production limitations.
- Protect the environment.
- No compulsory pooling.
- Compulsory field-wide unitization.

14

The Oil & Gas Lease

- All oil and gas leases address three general areas:
- 1. What are the ***rights granted***?
- 2. What is the ***duration*** of the grant?
- 3. ***Royalty***.

15

The Oil & Gas Lease

- **Granting clause:** what is the nature of the rights being conveyed to the lessee?
- **Texas:** defeasible term mineral interest.
- **Kansas:** defeasible term *profit a prendre*.
- **Pennsylvania:** depends upon the precise wording.

16

The Oil & Gas Lease

- ***Landowner conveys to oil company: "The exclusive right to explore for, develop, and produce oil and gas from the land including title to all oil and gas extracted from the Land."***

17

The Oil & Gas Lease

- "Lessee shall have free use of oil, gas, ***and water*** from said land, except water from lessor's wells and tanks, for all operations hereunder, including repressuring, pressure maintenance, cycling, and secondary recovery operations . . . ." **[Free Use Clause]**
- **Landowner cannot grant right to the water because it belongs to the State of Kansas.**

18

The Oil & Gas Lease

- Lessee must have right to use land that is used to make a permitted diversion of water.
- **K.S.A. 55-901(a)** "salt water" can be disposed of through KCC authorized injection without appropriation permit.
- Everything else requires an appropriation permit.

19

The Oil & Gas Lease

- "Lessee shall have the right . . . to remove all property and fixtures placed by lessee on said land, including the right to draw and remove all casing."
- "There shall be no obligation on the part of the lessee to offset wells on separate tracts into which the land covered by this lease may be hereafter divided by sale, devise, or otherwise, or to furnish separate measuring or receiving tanks."

20

The Oil & Gas Lease

- "When required by lessor, lessee will bury all pipe lines below ordinary plow depth."
- "Lessee shall pay for damages caused by its operations to growing crops on said lands." [**Crop Damage Clause**]
- "No well shall be drilled within two hundred feet (200 ft.) of any residence or barn now on said land without lessor's consent."

21

The Oil & Gas Lease

- "Lessor shall have the privilege, at his risk and expense, of using gas from any gas well on said land for stoves and inside lights in the principal dwelling thereon, out of any surplus gas not needed for operations hereunder." [**Free Gas Clause**]
- ***Schell v. OXY USA Inc.***, No. 07-1258-JTM, 2011 WL 4553091 (D. Kan. Sept. 29, 2011).

22

The Oil & Gas Lease

- "together with any reversionary rights and after-acquired interest, therein . . . ."
- "containing ___ acres, more or less, and all accretion thereto."
- "The rights of either party hereunder may be assigned in whole or in part and the provisions hereof shall extend to the heirs, executors, administrators, successors, and assigns . . . ." [**Assignment Clause**]

23

The Oil & Gas Lease

- "An assignment of this lease, in whole or in part, shall, to the extent of such assignment, relieve and discharge lessee of any obligations hereunder." [**Advance Novation Clause**]

24

The Oil & Gas Lease

- "Lessee and lessee's successors and assigns shall have the right at any time to surrender this lease, in whole or in part, to lessor . . . ; thereupon lessee shall be relieved from all obligations, expressed or implied, of this agreement as to the acreage so surrendered . . . ." **[Surrender Clause]**

25

The Oil & Gas Lease

- "Lessor hereby warrants and agrees to defend the title to said land, and agrees that lessee, at its option, may discharge any tax, mortgage, or other lien upon said land, and in the event lessee does so, it shall be subrogated to such lien with the right to enforce same and apply rentals and royalties accruing hereunder toward satisfying same." **[Warranty Clause; Subrogation Clause]**

26

The Oil & Gas Lease

- "In case said lessor owns a less interest in the above described land than the entire and undivided fee simple estate therein, then the royalties, including substitute gas royalty, and rentals herein provided for shall be paid the said lessor only in the proportion that his interest bears to the whole and undivided fee . . . ." **[Proportionate Reduction or Lesser Interest Clause]**

27

The Oil & Gas Lease

- **What is the effect of a proportionate reduction clause on the promised bonus? *Barker v. Boyer***, 794 P.2d 322, 324 (Kan. Ct. App. 1990). "It is *universally agreed* that the lesser interest clause acts on the *bonus*, delay rentals, and the lessor's royalty payable under an oil and gas lease."
- ***Brooks v. Mull***, 78 P.2d 879 (Kan. 1938).

28

The Oil & Gas Lease

- **What is the effect of a proportionate reduction clause on an "overriding royalty" retained in the oil and gas lease in addition to the "royalty"?**
- ***Barker v. Boyer***: "The reservation in issue herein is not stated to be limited to the oil and gas produced under the terms of this lease nor expanded to all oil produced from the described land, but simply states: '**LESSOR RESERVES A 1/16 OF 7/8 OVERRIDE**.'"

29

The Oil & Gas Lease

- "If the leased premises shall hereafter be owned in severalty or in separate tracts, the premises, nevertheless, shall be developed and operated as one lease, and all royalties accruing hereunder shall be treated as an entirety and shall be divided among and paid to such separate owners in the proportion that the acreage owned by each such separate owner bears to the entire leased acreage." **[Entireties Clause]**

30

The Oil & Gas Lease

- Warranty of title, in the oil and gas context, is often of limited value when production is obtained from the leased land.
- "[B]asic measure of damages . . . for a breach of covenants of warranty . . . is the value of the land ***at the time of the conveyance***, which is the consideration agreed upon by the parties . . . ." ***Maxwell v. Redd***, 496 P.2d 1320, 1326 (Kan. 1972). This is why ***Duhig*** is so important.

31

The Oil & Gas Lease

- Kansas has one case that addresses *Duhig*. It is an unreported case that cannot be found using WestLaw. However, it is available on the LexisNexis database: ***Grabs v. Dickson***, Case No. 58,991, 1986 Kan. App. LEXIS 1521 and Case No. 58,992, 1986 Kan. App. LEXIS 1524 (Kan. Ct. App. Nov. 13, 1986).

32

The Oil & Gas Lease

O ----------> Dickson
2/3 1/3

O ----------> Dickson ----------> Grabs
2/3 reserves 1/16

O ----------> Dickson ----------> Grabs
2/3 0/0 1/3

33

The Oil & Gas Lease

- "Apparently the *Duhig* rule has never been considered in Kansas. The rule appears logical, however, and provides a method of construing all such deed[s] consistently. An old Kansas case provides some support for applying the rule here. In ***Batterton v. Smith***, *3 Kan. App. 419, 421, 43 Pac. 275 (1896)*, the court held a grantee's knowledge of title defects did not prevent his recovery from his grantor for breach of warranty based on the title defects."

34

The Oil & Gas Lease

- "Dickson warranted he was conveying all the mineral but reserved 1/16. Based on our conclusion that he owned on[ly] 1/3, he, therefore, breached his warranty to convey 15/16 of the minerals and should now be estopped to assert any claim that he reserved any interest. Unlike *Duhig*, furthermore, even this resolution does not prevent his breach of warranty–he still failed to transfer (15/16 - 1/3) or 29/48 to Grabs."

35

The Oil & Gas Lease

- How about **K.S.A. 58-2202**: "[E]very conveyance of real estate shall pass all the estate of the grantor therein, *unless the intent to pass a less estate shall expressly appear or be necessarily implied* ***in the terms of the grant***."

36

The Oil & Gas Lease

- "Subject to the provisions herein contained, this lease shall remain in force for a term of ten (10) years from this date (called 'primary term'), ***and as long thereafter as*** oil, liquid hydrocarbons, gas or other respective constituent products, or any of them, ***is produced from said land*** or land with which said land is pooled." **[Habendum Clause]**

37

The Oil & Gas Lease

- "Produced" means produced in "paying quantities."
- What are "paying quantities"?
- ***Claiborne v. Galemore***, No. 103,163, 2010 WL 5490736 (Kan. Ct. App. Dec. 23, 2010) (unpublished opinion).

38

The Oil & Gas Lease

- "[I]f there is a gas well or wells on the above land (and for the purposes of this clause the term 'gas well' shall include wells capable of producing natural gas, condensate, distillate or any gaseous substance and wells classified as gas wells by any governmental authority) and such well or wells are shut in before or after production therefrom, lessee or any assignee hereunder ***may pay or tender***

39

The Oil & Gas Lease

- annually at the end of each yearly period during which such gas well or gas wells are shut in, as substitute gas royalty, a sum equal to the amount of delay rentals provided for in this lease . . . and ***if such payments or tenders are made*** it shall be considered under all provisions of this lease that gas is being produced from the leased premises in paying quantities." **[Shut-In Royalty Clause]**

40

The Oil & Gas Lease

- ***Levin v. MAW Oil & Gas, LLC***, 234 P.3d 805 (Kan. 2010).
- Court rejects any sort of bright-line test for when a well qualifies as a shut-in well (absent specific lease language) by being sufficiently complete to be deemed capable of producing.

41

The Oil & Gas Lease

- "Although ***Tucker*** asserts that the total absence of a market for natural gas is a prerequisite to classify a well as shut-in and thus bring into play a shut-in royalty clause, this assertion appears to arise out of an over interpretation of ***Pray*** and insufficient attention to the subject lessees' language. . . . ***In other words, Pray did not make the absence of a market a part of Kansas' definition of 'shut-in.'***"

42

The Oil & Gas Lease

- "If ***operations for drilling are not commenced*** on said land or on land pooled therewith on or before one (1) year from this date, this lease shall terminate as to both parties, unless on or before one (1) year from this date lessee shall ***pay or tender to the lessor a rental*** of ____ Dollars which shall cover the privilege of deferring commencement of such operations for a period of twelve (12) months. . . ." **[Drilling, Delay Rental Clause]**

43

The Oil & Gas Lease

- What are "**operations for drilling**"? Are they different from "**drilling operations**"? When are they **commenced**?
- When do you commence to bake a cake? When you mix the ingredients together? Or, when you put it in the oven?
- **In Kansas, anything less than actual drilling, with a rig capable of drilling to the targeted depth shown in a drilling permit, is risky.**

44

The Oil & Gas Lease

- ***Hall v. JFW, Inc.***, (Kan. Ct. App. 1995), *rev. denied.*
- ***Herl v. Legleiter***, (Kan. Ct. App. 1983).
- ***Bunnell Farms Co. v. Samuel Gray, Jr. & Associates***, (Kan. Ct. App. 2002).
- ***A & M Oil, Inc. v. Miller***, (Kan. Ct. App. 1986)
- **Kansas Supreme Court has not addressed the issue.**

45

The Oil & Gas Lease

- "**If prior to the discovery** of oil, liquid hydrocarbons, gas or their respective constituent products, or any of them, on said land or land pooled therewith lessee should ***drill and abandon a dry hole*** or holes thereon, **or if, after discovery** of oil, liquid hydrocarbons, gas or their respective constituent products, or any of them, the ***production thereof should cease from any cause***, this lease shall not terminate if lessee ***commences reworking or additional drilling operations*** within sixty (60) days thereafter,

46

The Oil & Gas Lease

- ***or*** **(if it be within the primary term)**, (i) ***in the case of a dry hole***, commences or resumes the payment or tender of rentals or commences operations for drilling or reworking on or before the rental paying date occurring twelve (12) months after the expiration of the rental period during which such dry hole was drilled, or

47

The Oil & Gas Lease

- (ii) ***in the case of cessation of production***, commences or resumes the payment or tender of rentals or commences operations for drilling or reworking on or before the rental paying date next ensuing after the expiration of three (3) months from the cessation of production. **[Dry Hole Clause; Cessation of Production Clause]**

48

The Oil & Gas Lease

- Will the cessation clause replace the cessation doctrine? "Cease from *any* cause"?
- ***Welsch v. Trivestco Energy Co.***, 221 P.3d 609 (Kan. Ct. App. 2009).
- Holding the lease terminated for non-payment of shut-in royalty and neither the cessation clause nor the force majeure clause apply.

49

The Oil & Gas Lease

- **Shut-in Roylaty Clause:** "at any time either before or after the expiration of the primary term of this lease, ***if there is a gas well*** or wells on the above land . . . ***and such well or wells are shut in*** before or after production therefrom, lessee . . . ***may pay*** or tender annually at the end of each yearly period during which such gas well or gas wells are shut in,

50

The Oil & Gas Lease

- as substitute gas royalty, a sum equal to the amount of delay rentals provided for in this lease . . . and ***if such payments or tenders are made*** it ***shall be considered under all provisions of this lease that gas is being produced from the leased premises in paying quantities***."

51

The Oil & Gas Lease

- **Cessation Clause:** "If , . . . after discovery of oil, liquid hydrocarbons, gas or their respective constituent products, or any of them, the ***production*** thereof should ***cease*** from ***any cause***, this lease shall not terminate if lessee commences reworking or additional drilling operations within sixty (60) days thereafter. . . ."

52

The Oil & Gas Lease

- Court holds lessee cannot rely upon the temporary cessation doctrine; the parties' rights in the event of a cessation "from any cause" are addressed by the cessation clause.
- No action taken within the 60-day time frame to commence "reworking or additional drilling."
- If the cessation clause replaces the temporary cessation doctrine, then the term "reworking" will need to be interpreted broadly.

53

The Oil & Gas Lease

- "If, at the expiration of the primary term, oil, liquid hydrocarbons, gas or their constituent products, or any of them, is not being produced on said land or land pooled therewith ***but lessee is then engaged in operations for the drilling or reworking or any well thereon***, this lease shall remain in force so long as drilling or reworking operations are prosecuted

54

The Oil & Gas Lease

- (whether on the same or different wells) with no cessation of more than sixty (60) consecutive days, and if they result in production, so long thereafter as oil, liquid hydrocarbons, gas or their respective constituent products, or any of them, is produced from land or land pooled therewith." **[Operations/Completion Clause]**

55

The Oil & Gas Lease

- "Lessee shall not be liable for delays or defaults in its performance of any agreement or covenant hereunder due to force majeure. . . ." **[Force Majeure Clause]**
- New York Marcellus moratorium.

56

The Oil & Gas Lease

- ***Welsch v. Trivestco Energy Co.***
- **Force Majeure Clause:** "Lessee shall not be ***liable for*** delays or defaults in its ***performance of any agreement or covenant*** hereunder due to force majeure. The term 'force majeure' as employed herein shall mean: any act of God . . . ; exhaustion or unavailability or delays in delivery of any product, labor, service, or material."

57

The Oil & Gas Lease

- The court holds this clause did not apply because nothing prevented the lessee from paying the shut-in royalty.
- This assumes the force majeure clause cannot be an independent basis for excusing performance.
- What if this were an "oil" well where the option to pay shut-in royalty did not exist?

58

The Oil & Gas Lease

- The court misses the more fundamental analysis to reject the lessee's force majeure claims:
- The clause only applies to covenants – not conditions.
- The court needs to apply the same covenant/condition analysis to this clause that it applied to the shut-in royalty clause.

59

The Oil & Gas Lease

- "The royalties to be paid by lessee are: (a) on oil, and other liquid hydrocarbons saved at the well, ***one-eighth of that produced*** and saved from said land, ***same to be delivered*** free of cost at the wells or to the credit of lessor in the pipe line to which the wells may be connected; **[Oil Royalty Clause]**

60

The Oil & Gas Lease

- "(b) on gas, including casinghead gas and all gaseous substances, produced from said land and sold or used off the leased premises or in the manufacture of gasoline or other products therefrom, the ***market value at the mouth of the well*** of one-eighth of the gas so sold or used, provided that on gas ***sold at the wells the royalty shall be one-eighth of the amount realized*** from such sale . . . ." **[Gas Royalty Clause]**

61

The Oil & Gas Lease

- The major dispute regarding royalty: at what ***location*** can or must the lessee do something with the extracted oil or gas?

62

The Oil & Gas Lease

- **The Pooling Clause**.
- Much more important with horizontal drilling and the need for larger drilling areas.
- If the authority is not contained in a pooling clause, will need to enter into a separate pooling agreement.

63

The Oil & Gas Lease

- **Lessor and Lessee Considerations When Leasing:** see Outline at page 24.
- **Lessor:** don't go first, land use, think small regarding the grant and duration of the grant, royalty – the most objective formula possible.
- **Lessee:** land use, pooling, clear duration, ability to prudently develop, royalty – the most objective formula possible.

64

The Oil & Gas Lease

- **Easement issues:** the blanket or floating easement problem.
- Guidance from the ***Restatement (Third) of Servitudes***.
- **§ 1.1(2)(c)**. Profits for the removal of oil, gas, and minerals "not within the scope of this Restatement" – "[t]o the extent that special rules and consideration apply" to them. **Not really much of a limitation.**

65

Conveyancing Issues

- **Marketable Record Title Act**, K.S.A. §§ 58-3401 to 58-3412. Of limited assistance (helpful only until a mineral interest is severed from the balance of rights in the property).

66

Conveyancing Issues

- **K.S.A. 79-420.** "Whenever the fee to the surface . . . is in any person . . . and the right or title to any minerals therein is in another . . . such mineral shall be listed . . . separately from the fee . . . . **When such reserves or leases are not recorded within 90 days after execution, they shall become void if not listed for taxation.**"

67

Conveyancing Issues

- **Mineral vs. Royalty.** Kansas law, as a practical matter, requires the owner of a severed interest in oil and gas to determine whether they own a "mineral" or a "royalty" interest.
- **Mineral Interest**: right to oil and gas "in place." Classic language is conveyance of oil and gas "in and under" the land.
- **Royalty Interest**: right to oil and gas as it is extracted. Classic language is conveyance of oil and gas "produced" from the land.

68

Conveyancing Issues

- **Reasons why it matters:**
- Mineral interest deemed to vest immediately and does not violate the Rule Against Perpetuities.
- Royalty interest not subject to K.S.A. 79-420.
- Mineral interest includes development rights and corresponding right to lease.
- Royalty interest is a passive income interest.
- Fractional "royalty" interest typically yields 8 times the production revenue as compared to a fractional "mineral" interest.

69

Conveyancing Issues

- Mineral interests can be **nonparticipating** in one or more of the mineral attributes or benefits under an oil and gas lease.
- The right to lease or develop oil and gas that is part of a mineral interest can be severed from the mineral interest.
- Benefits under an oil and gas lease can be severed from the mineral interest.

70

Conveyancing Issues

- For example, ***O*** conveys to ***A*** an undivided 50% of the oil and gas in and under § 30 but excepting in ***O*** the right to lease and develop the oil and gas conveyed to ***A*** together with the right of ***O*** to retain for himself all bonus and delay rental associated with any oil and gas lease covering ***A***'s nonparticipating mineral interest.

71

Conveyancing Issues

- **Rule Against Perpetuities.**
- The Kansas Supreme Court has held that creation of a perpetual royalty interest violates the Rule Against Perpetuities (the "Rule").
- For example: ***O*** conveys to ***A*** 1/16th of all the oil and gas produced from § 30.
- This is treated as a non-vested interest because the court has defined the vesting event as "production."

72

Conveyancing Issues

- At the date of the grant it cannot be said with certainty that there will be production from § 30 within a life or lives in being plus 21 years.
- Violates the Rule so ***A***'s interest is void. ***A*** owns nothing.
- A mineral interest is deemed by the court to vest upon delivery of the deed.

73

Conveyancing Issues

- Note, just like a royalty interest, we don't know if there will ever be production from § 30. But the royalty interest is void and the mineral interest is valid.
- Note also that a nonparticipating mineral interest, that participates in nothing but royalty, is nevertheless deemed to vest immediately and not subject to the Rule.

74

Conveyancing Issues

- The Rule in this context is being examined again in ***Rucker v. DeLay***, 44 Kan. App.2d 268, 235 P.3d 566 (2010). The Kansas Supreme Court accepted review of the case and heard oral arguments on September 28, 2011.

75

Conveyancing Issues

- **Uniform Statutory Rule Against Perpetuities**
- The "new" rules apply to transactions entered into on or after July 1, 1992.
- Primarily the exemption of "nondonative transfers." K.S.A. 59-3404(1).
- The 90-year wait-and-see provision. K.S.A. 59-3401(a)(2).
- The reformation provision. K.S.A. 59-3403.

76

Conveyancing Issues

- Important section that has retroactive effect (to help with all pre-July 1, 1992 transactions): K.S.A. § 59-3405(b).
- But, are these statutes part of a bill containing multiple subjects that violates article 2, § 16 of the Kansas Constitution – and is void? *See* David E. Pierce, *Void Enactments of the Kansas Legislature*, 80 J. Kan. B. Ass'n 28 (July/Aug. 2011).

77

Conveyancing Issues

- **Adverse Possession.**
- Many title problems are resolved by adverse possession. But problems associated with a previously-severed mineral interest will not be impacted by surface use.
- Once a mineral interest is severed from the surface, entry by an adverse possessor of the surface will not impact the severed mineral interest.

78

Conveyancing Issues

- **Easements by Necessity**
- **Severed Mineral Interest.** ***O*** conveys to ***A*** the oil and gas in § 30. If the deed contains no further language addressing the scope of ***A***'s mineral rights, ***A***'s rights include the right to make reasonable use of the surface to extract the oil and gas.

79

Conveyancing Issues

- **Oil and Gas Lessee.** Although oil and gas leases typically contain express provisions – easements – to use the surface to support oil and gas operations, if the lease were silent on the matter the lessee would nevertheless enjoy an implied right to make reasonable use of the surface.

80

Special Issues

- **What Does the Landowner *Own*?**
- Traditionally landowners often misconceive what they "own" when their mineral interest is subject to an oil and gas lease.
- Often mix-up not only the nature of the interest ("royalty" as opposed to "mineral"), but also the fraction of ownership ("1/8th" as opposed to "8/8ths").
- Can have unique situation where a conveyance of a "1/8th royalty interest" is intended to convey an "8/8ths mineral interest."

81

Special Issues

- ***Heyen v. Hartnett***, 235 Kan. 117, 679 P.2d 1152 (1984) (1/16th mineral interest intended to convey ½ the minerals).

82

Special Issues

- **Nonapportionment Doctrine**
- **2005**: ***O*** enters into oil and gas lease with ***X*** covering all of § 30 with a primary term of 3 years and a 1/8th royalty.
- **2006**: ***O*** conveys to ***A*** the NW1/4 of the NW1/4 of § 30.
- ***X*** drills a well on the NW1/4 of the NW1/4.
- How will royalty under the lease be divided?

83

Special Issues

- Nonapportionment doctrine: ***A*** receives all the royalty; ***O*** gets nothing.
- Does the lease have an "entireties clause"? If so, the effect will be to give ***A*** 40/640 x 1/8th and ***O*** 600/640 x 1/8th.
- Does the deed creating the divided interest in ***A*** address the issue? Rarely.

84

Special Issues

- **Final Examination.**
- Successive interest rights (life estate and remainderman).
- Concurrent interest rights (cotenancy).

85