Nebraska Law Review

Volume 34 | Issue 4 Article 12

1955

Oil and Gas—Effect of Entirety Clauses on Grantees Taking under Deeds Subject to Lease

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OIL AND GAS—EFFECT OF ENTIRETY CLAUSES ON GRANTEES TAKING UNDER DEEDS SUBJECT TO LEASE

Often the owner of land places it under an oil lease, and later conveys fee interests or mineral or royalty interests in segregated tracts from the leased area. When oil is subsequently produced on some, but not all of the leased area, problems may arise as to the royalty rights of the lessor and the grantees. Specifically, is the right of each grantee to royalties modified by the fact that his tract is part of a larger leased area? The problem will be considered in the absence and in the presence of the contractual device known as the entirety clause.[1]

Various types of conveyances may give rise to this problem: conveyance of an interest in the fee; conveyance of an interest in the minerals under the land; or conveyance of an interest in royalties. Unless otherwise indicated, "conveyance" henceforth in this note will refer to conveyance of interest in the minerals.

1 An entirety clause provides that if portions of the leased tract come into separate ownerships, the royalties shall be paid to the separate owners in the proportion that the acreage owned by each bears to the entire acreage.

The weight of authority holds that the grantee of a tract from a parcel of land held under an oil lease is entitled to all the royalties produced from his tract, and to none of the royalties from any other tract covered by the lease. The rationale is that the grantee bought only the royalties from one tract and his rights are not affected by the fact that other tracts are under the same oil lease.[2]

The rule seems logical enough on its face, but sometimes it produces quite harsh results. Consider the Oklahoma case of *Galt v. Metscher.*[3] There it was held that the lessee had a right to develop the land as a unit and the purchaser of the south 80 of a 160 acre tract had no interest in a well drilled on the north 80—even though the well was just four feet from the dividing line. Probably much of the oil in which the owner of the south 80 was adjudged to have no interest was taken from underneath his land.

It may be argued that such result is not inequitable, since the grantee gambled that the well would be drilled on his tract, in which case he would take all. A rule which imposes such an all-or-nothing prospect upon a purchaser, however, serves to render an inherently speculative field even more speculative. Furthermore many courts have felt that an undue hardship is worked on a grantee who can receive no compensation for oil taken from underneath his land through a well on the same lease.[4]

Of course a decision adopting this result may have the effect of mitigating the hardship in case of deeds executed subsequent to the decision, since the parties can adjust the price in view of the decision. The element of increased speculativeness would still be present, however.

Galt v. Metscher[5] said in effect that the parties could remedy

[2] Cases holding the sans clause, grantee takes all from his tract and only from his tract: Central Pipe Line Co. v. Hutson, 401 Ill. 447, 82 N.E.2d 624 (1948); Carlock v. Krug, 151 Kan. 407, 99 P.2d 858 (1940); Japhet v. McRae, 102 Tex. Cr. 310, 276 S.W. 669 (1925); Galt v. Metscher, 103 Okla. 271, 229 Pac. 522 (1924); Kimbley v. Luckey, 72 Okla. 217, 179 Pac. 928 (1919); Osborn v. Ark. Territorial Oil & Gas Co., 103 Ark. 175, 146 S.W. 122 (1912); Northwestern Ohio Natural Gas Co. v. Ullery, 68 Ohio St. 259, 67 N.E. 494 (1903). Contra: Cook v. Cook's Adm'r, 261 Ky. 501, 88 S.W.2d 27 (1935); Wettengel v. Gormley, 160 Pa. 559, 28 Atl. 934 (1894).

[3] 103 Okla. 271, 229 Pac. 522 (1924).

[4] Thomas Gilcrease Foundation v. Stanolind Oil & Gas Co., 266 S.W.2d 850 (Tex. 1954); Galt v. Metscher, 103 Okla. 271, 229 Pac. 522 (1924).

[5] 103 Okla. 271, 229 Pac. 522, 524 (1924).

the situation by contract. There are numerous devices, which, while conceived to solve various problems of oil and gas production, have some bearing on the instant problem. These include the joint or community lease, the lease pooling clause, separate pooling agreements, and equitable pooling.[6] This note, however, is concerned solely with the device known as the entirety clause.

An entirety clause in an oil lease provides that if the leased land passes into separate ownership, the premises shall nevertheless be developed as an entirety and all royalties accruing under the lease shall be divided among the separate owners in the proportion that the land of each bears to the entire leased acreage. A typical clause reads as follows:

> If the leased premises shall hereafter be owned severally 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.[7]

When mineral deeds which contain a provision making them subject to lease are later executed, an entirety clause will usually be enforced to result in pro rata sharing of the royalties by the owners of interests in the separate tracts.[8]

Louisiana is the only state which has refused to enforce entirety clauses. In a 1936 decision, the Louisiana Supreme Court enforced such a clause;[9] but the following year, the same court, without citing the previous case, refused enforcement.[10] The latter case dealt with a deed assigning the royalties instead of a deed conveying the minerals, and the lease read "in proportions according to the acreage and/or interest owned by each" instead of the usual phrasing "in the proportion that the acreage owned by each bears to the entire leased acreage." The real rationale of the holding, however, was probably that the clause was inserted into the lease solely for the benefit of the lessee, who did

6 Hoffman, Voluntary Pooling and Unitization (1954).

7 Id. at 186.

8 Carter Oil Co. v. Crude Oil Co., 201 F.2d 547 (10th Cir. 1953); Thomas Gilcrease Foundation v. Stanolind Oil & Gas Co., 266 S.W.2d 850 (Tex. 1954); Harley v. Magnolia Petroleum Co., 378 Ill. 19, 37 N.E.2d 760 (1941); Eason v. Rosamond, 173 Okla. 10, 46 P.2d 471 (1935); Schrader v. Gypsy Oil Co., 38 N.M. 124, 28 P.2d 885 (1933); Gypsy Oil Co. v. Schonwald, 107 Okla. 253, 231 Pac. 864 (1924).

9 Shell Petroleum Corporation v. Calcasieu Real Estate & Oil Co., 185 La. 751, 170 So. 785 (1936).

10 Shell Petroleum Corporation v. Carter, 187 La. 382, 175 So. 1 (1937).

not assert that ignoring the entirety clause would increase his obligations or diminish his rights.

The argument that entirety clauses are for the sole benefit of the lessee is seriously weakened by the fact that far less drastic provisions will protect the lessee just as fully. At least one present day lease contains a provision that if a certain number of persons become interested in the royalty, the lessee shall not be required to make payment until the interested persons have designated in writing some agent to receive payment for all;[11] or that regardless of division of ownership, the lessee shall not be required to measure separately the production from any segregated tract or to protect any segregated tract against inside drainage.[12]

One recent Oklahoma case may be thought to stand for rejection of entirety clauses, but actually the court only refused to apply a clause to an unusual fact situation.[13] The deed conveyed the minerals in a specifically designated tract for the duration of the existing lease. The court reasoned that the specific tract designations, if accorded any meaning at all, would have to be applicable to the lease period. The court distinguished this situation from the other Oklahoma cases enforcing entirety clauses[14] by noting that in those cases the entirety clause could be applied during the life of the lease, and the specific tract designation thereafter.

The above case does raise a problem, however, in that it seems to condition enforcement of the clause upon the provision of the mineral deed. There is language in some cases to the effect that the clause so binds the lessor that he cannot make any subsequent inconsistent disposal of the land or mineral rights.[15] If strictly applied, such interpretation of the effect of the clause would presumably render the clause binding even upon grantees whose deeds do not contain any reference to a lease. Such rigid application of the clause might seem unjust when there is only one grantee, but might be necessary where there is more than one grantee to avert complex problems of the respective rights of grantees whose deeds are subject to lease, and those whose

11 Producers 88, revised 1943, as printed in Kulp, Cases on Oil & Gas 835, 842 (3d ed. 1947).

12 Ibid.

13 Iskin v. Consolidated Gas Utilities Corp., 207 Okla. 615, 251 P.2d 1073 (1952).

14 Eason v. Rosamond, 173 Okla. 10, 46 P.2d 471 (1935); Gypsy Oil Co. v. Schonwald, 107 Okla. 253, 231 Pac. 864 (1924).

15 Ibid.

deeds are not subject to lease. Where there are only two grantees, for example, refusal to enforce the clause in regard to one of the grantees would nullify it as to the other, unless the lessor could be forced to compensate the subject-to grantee for non-enforcement. Just how far jurisdictions which enforce entirety clauses will allow the clauses to be modified by the terms of mineral deeds is a question which awaits further judicial clarification.

An Illinois case has been cited as limiting the effect of entirety clauses by implying that the clauses would not be enforced where proper ground for reformation of the mineral deed existed.[16] Actually the case does not greatly curtail the usefulness of the clauses. The grantor and grantee signed a deed subject to a lease with neither of them knowing that the lease contained an entirety clause. After oil was produced on the grantees' land, they sought reformation of the deed on the ground of mutual mistake of fact. The court denied reformation, stating that when parties sign a deed which they know to be subject to a lease, the terms of which they are consciously ignorant, they manifestly conclude that those terms would not induce them to refrain from entering into the agreement. This statement may be only dictum, since one grantee's attorney had a copy of the lease before signing the deed and the other grantee learned of the clause (and dismissed it as unimportant) after signing but before oil production.[17] Even in the absence of these last two factors, however, the result is in accord with Nebraska and general contract law.[18] Thus parties who sign deeds made subject to a lease cannot get reformation later on the ground that they did not know of the presence of an entirety clause in the lease.

Entirety clauses appear to be eminently enforceable in Nebraska. In a very recent case the Supreme Court of Nebraska enforced a clause even though the tracts involved were non-contiguous and apparently not even in the same geological structure.[19] While other courts have enforced entirety clauses covering non-contiguous tracts,[20] there appears to be no other case in which an entirety clause was enforced on tracts not of the same geological structure.

16 Harley v. Magnolia Petroleum Co., 378 Ill. 19, 37 N.E.2d 760 (1941).
17 Id. at 766.
18 Farmer's Loan & Trust Co. v. Suydam, 69 Neb. 407, 95 N.W. 867 (1903); see 137 A.L.R. 900 (1941).
19 Rauner v. Jones, 159 Neb. 385. 67 N.W.2d 347 (1954).
20 Schrader v. Gypsy Oil Co., 38 N.M. 124, 28 P.2d 885, 888 (1933).

The holding is quite logical in terms of the statements of some of the cases that an entirety clause precludes a lessor from making any subsequent inconsistent conveyance. If the clause is viewed as a covenant running with the whole leased area, such factors as structural differences become irrelevant. If the clause is viewed in terms of its purpose, however, the wisdom of its application to tracts on different structures is far less clear. The divestiture of oil from beneath a tract without compensation to the owner is the primary evil which entirety clauses seek to avert, but it is an evil which cannot occur in regard to tracts on different geological structures. Indeed, enforcement in such situations produces the same type inequity which the clauses seek to avert, in that it transfers royalties from the owner of an interest in producing land to the owner of an interest in another tract which could not have contributed to the production.

There are factors, however, which militate for the enforcement of the clauses even in such extreme situations. The owner of an interest in a segregated tract can be seriously harmed in ways other than by uncompensated drainage of his oil through other wells on the leased area. Since the lessee may usually continue to hold the lease as long as he produces from the leased area, the owner may never get oil production from his tract. Nor may he get delay payments from the lessee, since delay payments are excused by production anywhere within the leased area. These inequities may be mitigated somewhat by implied covenants on the part of the lessee to reasonably develop the entire leased area once production has been obtained from any part of the area.

CONCLUSION

Enforcement of entirety clauses is desirable in precluding the uncompensated taking of oil from an owner of a tract in a leased area through drillings on other tracts in the area. It results in alleviation of hardship upon the owner of mineral interests and lessens the speculative element in the purchasing of such interests. When the tracts to which the clause is sought to be enforced are not on the same geological structure, however, the desirability of enforcement is less clear. If the clause is enforced, the owner of interests in a producing tract will be compelled to share royalties with the owner whose tract did not contribute to the production. If the clause is not enforced, a tract owner may be doomed to a long period of non-development of his tract, with no compensation for the delay. The equities favoring enforcement have apparently met with the favor of the Nebraska Supreme Court, and that court will enforce an entirety clause covering tracts not of the same structure. In Nebraska, as elsewhere, the extent, if any, to which parties may alter the effect of the clause through subsequent provisions in deeds has not yet been decided.

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