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Oil and Gas—Mineral Deeds—Royalty Assignments—Parol Evidence

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RECENT MONTANA DECISIONS

OIL AND GAS—MINERAL DEEDS—ROYALTY ASSIGNMENTS—PAROL EVIDENCE—Plaintiff-buyer and defendant-sellers entered into a land contract whereby the sellers were to convey the land by "good and sufficient warranty deed" "excepting and reserving unto the said first parties [sellers] all except two percent (2%) of the landowner's royalty rights in and to all oil, gas and other minerals in, under or upon said premises, said two per cent (2%) of said landowner's royalty right to be deeded to the said second party." At the time the contract was entered into the land was not under oil and gas lease, but the sellers subsequently leased the land reserving a 12½ per cent royalty. Buyer made all his payments and tendered a deed to the seller for execution which reserved a 10½ per cent royalty. The seller refused to execute this deed and tendered to the buyer a deed reserving "all of the oil and gas and other minerals, in, under and that may be produced from said land," along with a separate two per cent royalty assignment. The buyer refused to accept these instruments and brought suit for specific performance. The seller cross-complained alleging that the contract was ambiguous and praying for a declaratory judgment that the instruments which he had executed and tendered to the buyer were in compliance with the contract. The trial court held that the contract was not ambiguous, excluded parol evidence of intent, and held for the buyer. On appeal to the Supreme Court of Montana, *held,* reversed and remanded for new trial. The reservation is ambiguous and thus the trial court erred in refusing to admit parol evidence. *Stokes v. Tutvet,* 328 P.2d 1096 (Mont. 1958).

Before discussing the instant case a brief resume of some basic Montana oil and gas law and a cursory distinction between the concepts "mineral" interest and "royalty" interest is in order. Montana is an ownership-in-place state.[1] That is, oil and gas, despite their fugacious nature, are a part of the real estate so long as they remain in it. A conveyance of the land carries with it the minerals unless they are expressly excepted.[2] The mineral estate, which includes oil and gas, may be severed from the surface estate so that one or more persons may own the mineral estate in fee simple and one or more different persons may own the surface estate.[3] The owners of the mineral estate are *not* tenants in common with the owners of the surface estate, although fractional owners of the mineral estate are tenants in common with one another.[4]

As the court in the instant case indicated, the owners of the mineral estate have the following rights: (1) the right to enter upon the land to explore for and produce oil and gas subject, of course, to an existing lease; (2) the right to lease the property for oil and gas exploration and production; (3) the right to share in the bonus under future leases; (4) the right to share in delay rentals under existing and future leases; and (5) the right to share in the production under existing and future leases. This latter right is known as the royalty right or the landowner's royalty right.

[1]Gas Products Co. v. Rankin, 63 Mont. 372, 207 Pac. 993, 24 A.L.R. 294 (1922).
[2]REVISED CODES OF MONTANA, 1947, § 67-1608.
[3]Rist v. Toole County, 117 Mont. 426, 159 P.2d 340, 162 A.L.R. 406 (1945).
[4]Henderson v. Chesley, 229 S.W. 573 (Tex. Civ. App. 1921); SULLIVAN, HANDBOOK OF OIL AND GAS LAW 48 n.48 (1955).

Standing alone, "royalty" means a share of the produce or profit paid to the owner of the mineral interest.[5] It is analogous to the agricultural lease wherein the owner of the land is paid a share of the crop. Ordinarily, royalty is payable in terms of a set share of the gross production from the land without any deduction for the costs of production.[6]

A royalty interest may be transferred by the mineral owner either before or after the land is leased, or after oil and gas are being produced.[7] The assignee of a royalty interest has no rights in the land other than the right to a share of the production, if and when production is obtained.[8] The mineral owner, following a royalty assignment, retains all of the rights enumerated above except the right to that share of the royalty which he has transferred to the royalty owner.[9] Thus, while a mineral owner can obtain income (bonuses and delay rentals) in the absence of production, the royalty owner will get nothing unless and until there is production.

Ordinarily, a fractional mineral owner is entitled to only his proportionate share of the royalty.[10] Assuming the usual lease (⅛th or 12½ per cent of production to the lessors and ⅞ths or 87½ per cent to the lessee) the owner of one-half of the minerals would be entitled to one-half of the royalty; *i.e.,* one-half of ⅛th, or, 1/16th of gross production. Stated in the terms of the principal case, if the sellers reserved a mineral interest, they reserved 98 per cent of the minerals and would be entitled to 98 per cent of the bonus and delay rentals. They would also have a right to 98 per cent of the royalty; *i.e.,* 98 per cent of 12½ per cent, or, 12¼ per cent of gross production. In that event, the purchaser would get only two per cent of the bonus and delay rentals; and his royalty interest would likewise be only two per cent of 12½ per cent, or, ¼ of one per cent of the gross production.

On the other hand, if the sellers reserved a royalty interest, they would get none of the bonus or delay rentals and only 10½ per cent of the gross production. The purchaser would receive all of the bonus and delay rentals and two per cent of the gross production. With such markedly different financial results flowing from the determination of whether a royalty interest or a mineral interest was reserved, the reason of the litigation over the instant contract becomes obvious.

As stated above, "royalty" means a share in production. Hence, words which contemplate or refer to production, such as "produced" or "produced and saved," are generally associated with a royalty interest.[11] A mineral interest, on the other hand, contemplates a grant or reservation of the minerals in place, and thus language which refers to the minerals in the ground, such as "in, under or upon" the land is generally associated with a mineral interest.[12] The problem of what interest was reserved or

[5]Hinerman v. Baldwin, 67 Mont. 417, 215 Pac. 1103 (1923).
[6]Marias River Syndicate v. Big West Oil Co., 98 Mont. 254, 38 P.2d 599 (1934).
[7]Rist v. Toole County, 117 Mont. 426, 159 P.2d 340, 162 A.L.R. 406 (1945).
[8]*Ibid.*
[9]*Ibid.*
[10]Swearingen v. Oldham, 195 Okla. 532, 159 P.2d 247 (1945).
[11]Rist v. Toole County, *supra* note 7; Mitchell v. Hannah, 123 Mont. 152, 208 P.2d 812 (1949); Miller v. Speed, 259 S.W.2d 235 (Tex. Civ. App. 1952); Armstrong v. McCracken, 204 Okla. 319, 229 P.2d 590 (1951).
[12]Rist v. Toole County, *supra* note 7; Mitchell v. Hannah, *supra* note 11; Miller v. Speed, *supra* note 11; Armstrong v. McCracken, *supra* note 11; Swearingen v. Oldham, *supra* note 10; Miller v. Speed, *supra* note 11.

conveyed arises when royalty, or other words which ordinarily indicate only an interest in production, are used with words which usually indicate a mineral interest. The reservation in the case at bar is a prime example of such a conflict. In such a case, in the absence of other language in the instrument establishing the intent of the parties, the court must either give controlling effect to only part of the language used, or admit parol evidence to determine what the parties intended to be the meaning of the instrument. In the case at bar the court has done both.

Briefly stated, the rationale of the decision of the instant case is this: (1) While the Montana Supreme Court has often stated that "royalty," used alone, means a share of the production paid to the owner of the land, in practice, when "royalty" has been used in conjunction with other words the court has given it a meaning consistent with the meaning of the other words. (2) *Marias River Syndicate v. Big West Oil Co.*[13] held that "royalty," used in conjunction with the words "found in or located upon or under said land . . . or that may be produced therefrom," denoted a "mineral" interest. Due to the large number of land contracts presumably drafted in reliance on the *Marias River* case during the twenty-four years since it was decided, the court felt obliged to follow it. Thus, ordinarily the reservation in question would have been held to be a mineral interest. (3) However, the sellers' contention that the purchaser was to receive two per cent of the gross production (as shown by their tender of a two per cent royalty assignment) was inconsistent with their simultaneous contention that the reservation was of the entire mineral interest. The sellers relied on the term "landowner's royalty" in one part of the contract to establish a reservation of the mineral estate, and at the same time, relied on the same term to show that the buyer was to get only an interest in production—a "royalty." If the term indicated a mineral interest in the first instance, the purchaser should have gotten a two per cent mineral interest. Yet if the purchaser got two per cent of the minerals, he would be entitled to but two per cent of the royalty paid the lessor by the lessee; *i.e.*, two per cent of 12½ per cent, or ¼ of one per cent of gross production. Thus the reservation was ambigous, and the trial court erred in not admitting parol evidence to determine the intent of the parties.

The court was clearly correct, for several reasons, in holding that the reservation in question is ambiguous. First, assuming that a royalty was intended, how much is a landowner's royalty? While it may be conceded that the ordinary lease in Montana calls for a 12½ per cent royalty, it would not be unusual for a mineral owner whose land were surrounded by producing lands to obtain a considerably larger royalty, nor would there be anything wrong with a lease calling for a lesser royalty. The court took judicial notice of the fact that the royalty is fixed by the relative bargaining position of the lessor.[14]

The fact that the term "landowner's royalty" does not refer to any fixed amount of production points up a further ambiguity in the reservation. The reservation provided that the sellers should retain "all except two per cent (2%) of the landowner's royalty rights . . . said two per cent (2%) of said landowner's royalty rights to be deeded to the said second

[13]98 Mont. 254, 38 P.2d 599 (1934).
[14]Instant case at 1104.

party." If the reservation were a royalty interest the purchaser would have all the mineral rights, and thus the leasing rights; what then would prevent the purchaser from leasing the land retaining only a two per cent royalty? In that event it would seem that the seller would obtain nothing. On the other hand, since the purcahser would obtain no benefit from entering into a lease calling for more than a two per cent royalty, there would be no incentive to him to try to lease the land at any higher royalty. The untenable position in which the sellers—the owners of *all* but two per cent of the royalty rights—would be makes it extremely unlikely that the sellers ever intended to enter into such a contract.

A further ambiguity in the instrument is illustrated by the language, "two per cent (2%) *of* the landowner's royalty rights." Construed literally, this means two per cent *times* the landowner's royalty.[15] If we assume the ordinary lease with a 12½ per cent landowner's royalty, the purchaser would receive .02 *times* .125, or, ¼ of one per cent. While it might be reasonable for a person to purchase ¼ of one per cent of the oil and gas produced from land having producing wells,[16] it seems very unlikely that anyone would purchase such a small royalty in land without proven petroleum deposits. This latter argument applies with equal force to the sellers' contention that the reservation is a mineral interest, since, if the purchaser bought only two per cent of the mineral rights, he would be entitled to but two per cent of a 12½ per cent royalty, or, ¼ of one per cent of production.

It is recognized that the above arguments go to the wisdom of the contract rather than to its ambiguity in a legal sense. Nonetheless, when the literally interpreted terms of a contract result in legal relationships which the parties are very unlikely to have desired, there is some ground for finding the contract ambiguous.

The most substantial ambiguity, the one with which the court was primarily concerned, is the use of the term "landowner's royalty rights" in conjunction with the words "in, under or upon" the land, and the total absence of any additional language to indicate the intent of the parties. As previously indicated, the words "in, under or upon" are normally associated with a mineral interest, while "landowner's royalty" refers to a share of the oil and gas actually produced from the land. In deciding that the words "in, under or upon" the land should control, and thus that the reservation would ordinarily be held to be a mineral interest, the court relied heavily on the 1934 Montana case of *Marias River Syndicate v. Big West Oil Co.*[17]

In the *Marias River* case the court was confronted with a deed which reserved a "12½ per cent interest and royalty in and to all oil and gas . . . found in or located upon or under said land . . . or that may be produced therefrom." As interpreted by the court in subsequent cases,[18] the reservation was held to be a mineral interest by virtue of the use of the words "found in or located upon or under" said land. Inasmuch as in that

[15] SULLIVAN, *op. cit. supra* note 4, at 223.
[16] *E.g.*, Rist v. Toole County, 117 Mont. 426, 159 P.2d 340, 162 A.L.R. 406 (1945), concerns royalty owners having as little as 1/10th of 1% royalty. However, the land involved was in the Kevin-Sunburst field.
[17] *Supra* note 13.
[18] Rist v. Toole County, *supra* note 16; Mitchell v. Hannah, 123 Mont. 152, 208 P.2d 812 (1949).

case the words "found in or located upon or under" prevailed over both "royalty" and "that may be produced therefrom," it would seem to follow logically that "in, under or upon" should prevail over "landowner's royalty rights" in this case. This was apparently the reasoning of the court. Yet who can deny that an instrument containing but two phrases, each indicating a different and conflicting interest, is ambiguous. Clearly the court was correct in remanding the case for a new trial with instructions to admit parol evidence as to the intent of the parties.

In addition to the reservation being ambiguous, the decision itself is somewhat ambiguous in that it does not decide with any marked degree of finality whether or not the word "royalty" will be given its ordinary meaning when used in the future. At the outset of the opinion the court said: "The wording is susceptible of several interpretations and we think reasonably so. The trial court was thrown into error by his belief that the terms of the contract were not at all ambiguous."[19] Toward the end of the opinion the court stated:[20]

> This court . . . has repeatedly and consistently given strict interpretation to the qualifying words with which the word "royalty" appears. Although Montana has consistently stated rather pontifically, that the word "royalty" has a strict meaning, nevertheless we have just as consistently ignored the word when it is used in conjunction with others, and looked to its associates to construe its meaning. *So long as* Montana adheres to this principle we do not feel impelled to give the word "royalty" any more strict construction than it has been given in the past. The mere fact "landowner's royalty" appears in this instrument would normally be given no more emphasis than it has in the past, for we would be impelled, by *stare decisis* to follow the Marias River case. [Emphasis added.]

This language is susceptible of two constructions: (1) that the words "in, under or upon" have been indicative of a mineral interest for so long—twenty-four years since *Marias River* was decided—that their use, as a rule of property, creates a mineral interest, and if any change is to be made the legislature must make it; or (2) that the reservation is clearly ambiguous and thus the court did not have to make a final decision as to whether "landowner's royalty" or "in, under or upon" the land is the controlling language in this instance.

It is also possible that the above-quoted language divested the word "royalty" of any intrinsic meaning when used in a Montana oil and gas conveyance. If the court, in construing the word "royalty" must always look to the language with which it is associated, it would seem that a conveyance of a "royalty" might be totally ineffective unless it also contained the phrase "produced and saved." Such an interpretation of the instant case would be undesirable, and would seem to be a broader rule than is necessary for the decision. Hence, it seems more likely that the court rather intended to say that it would construe the word "royalty" in the light of the associated language *only* if that language were in conflict with the ordinary meaning of "royalty."

[19] Instant case at 1099.
[20] *Id.* at 1103.

The problem of the weight and the efficacy to be given to the use of the word "royalty" in oil and gas instruments is one which has long plagued the courts in the principal oil and gas states. The decisions are far from uniform and considerable vacilliation occurs even within the same jurisdiction. Since 1923,[21] the Supreme Court of Montana has consistently stated in almost every oil and gas case to come before it that the word "royalty" has a well defined meaning. "Royalty" is generally understood in the oil and gas industry to mean a share of the production.[22] Thus, both the court and the oil industry concur as to the meaning of the term. Further, all concerned concur in the distinction between the rights of a royalty owner and the rights of a mineral owner.[23] Hence the desirability of the court giving great, if not always controlling, weight to the use of the word "royalty" in an oil and gas instrument seems obvious.

The court was well aware of the desirability of giving considerable weight to the use of the word "royalty." That is shown both by the fact that the court wrote an earlier opinion[24] on this same case in which it gave controlling effect to the term "landowner's royalty," and by the following quotation from the instant decision:[25]

> Perhaps, when the Marias River case was decided, it might have been a better result to have strictly construed the word "royalty," rather than giving more importance to the fact the words "in, under and upon" were used. . . .

The factor which apparently influenced the court not to give controlling effect to the use of the term "landowner's royalty," as did the trial court, was the fear that many long-standing mineral and royalty titles would be disturbed.[26] As was pointed out above, in the *Marias River* case the court held that a reservation of "12½ per cent interest and royalty in and to all oil and gas . . . found in or located upon or under the land . . . or that may be produced therefrom" reserved a mineral interest. While in the opinion of this author the *Marias River* decision was not based on the use of the words "found in or located upon or under the land," two subsequent decisions[27] of the Montana court have distinguished the *Marias River* instrument from the ones then before the court on the ground of the use of those words in *Marias River* and their absence in the instruments then in question. Accepting this interpretation of the *Marias River* decision as correct, and accepting the court's assumption that many mineral and royalty titles are based on the *Marias River* holding, the balance struck by the court here between the conflicting interests seems to be the correct one. Conceding the desirability of the court's giving considerable if not

[21]Hinerman v. Baldwin, 67 Mont. 417, 215 Pac. 1103 (1923).

[22]Homestake Exploration Corp. v. Schoregge, 81 Mont. 604, 264 Pac. 388 (1927).

[23]Rist v. Toole County, *supra* note 16; Mitchell v. Hannah, *supra* note 18; Voyta v. Clonts, 328 P.2d 655 (Mont. 1958).

[24]15 State Rep. 52 (Mont. Jan. 16, 1958).

[25]Instant case at 1103.

[26]"We may rightfully assume that many land contracts have been executed with the thought in mind of conforming the provisions of a mineral grant to those in the Marias case." *Ibid.*

[27]Rist v. Toole County, 117 Mont. 426, 159 P.2d 340, 162 A.L.R. 406 (1945); Mitchell v. Hannah, 123 Mont. 152, 208 P.2d 812 (1949).

always controlling weight to the use of the word "royalty," few persons would argue that it should be done at the expense of long settled land titles.

An unfortunate, though probably unavoidable, result of the instant case is that it is now extremely unlikely that the Montana court will ever give controlling effect to the word "royalty," if it is used in an oil and gas conveyance which contains any conflicting language looking toward a mineral interest.

In any event it is clear both from the principal case and from prior decisions, that an instrument intended to convey a share in production should state that the interest transferred is a "royalty in and to all oil and gas produced and saved" from the land.[28] If on the other hand, the parties intend the instrument to convey all or part of the minerals in place, the instrument should convey the "minerals in, under and upon the land."[29]

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PHYSICIANS AND SURGEONS—MALPRACTICE—EXTRAJUDICIAL ADMISSIONS OF THE DEFENDANT—Plaintiff had his gall bladder removed and a T-tube inserted, extending from the common duct to the outside of the abdomen. After plaintiff returned home from the hospital, he went to defendant physician's office to have the T-tube irrigated with a solution of alcohol and ether. Immediately following the irrigation, plaintiff became desperately ill and had to return to the hospital for an extended time. In an action against the defendant for malpractice, the plaintiff alleged that the physician was negligent in the irrigation of the T-tube and that, as a result of such negligence, plaintiff's liver was irrigated and severe injury caused. The defendant died pending the action and his estate was substituted as party defendant. An expert medical witness stated at the trial that it was not an accepted medical practice to irrigate the liver with an alcohol-ether solution. He also stated that in his opinion the liver of the plaintiff had not been irrigated. Plaintiff's daughter testified that the defendant admitted to her that he had irrigated the liver through the T-tube with pressure, and that the irrigation had caused the subsequent pain and irritation. The district court granted a nonsuit on the ground that the plaintiff failed to show by expert testimony that the irrigation of the T-tube had been performed negligently and that the liver had been irrigated. On appeal to the Supreme Court of Montana, *held,* reversed. The admission of the defendant was sufficient to show negligence. *Thomas v. Merriam,* 337 P.2d 604, (Mont. 1959) (Justice Castles and Dist. Judge Shea, dissenting).

The Montana Supreme Court has defined malpractice as "bad or unskillful practice . . . and comprises all acts and omissions of a physician or surgeon as such to a patient as such, which may make the physician or surgeon either civilly or criminally liable."[1]

In proof of malpractice there are usually three separate considerations —establishment of the applicable standard of care, proof of the defendant's

[28] *Ibid.* See also 3A SUMMERS, OIL AND GAS 241 (perm. ed. 1958).
[29] SUMMERS, *op. cit. supra* note 28, at 242.
[1] Bakewell v. Kahle, 125 Mont. 89, 93, 232 P.2d 127, 129 (1951).