Modern Applications of the Rule against Perpetuities to Oil and Gas Transactions: What the Duke of Norfolk Didn't Tell You

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ABSTRACT

The venerable Rule Against Perpetuities has been plaguing property lawyers for over 300 years. Oil and gas attorneys need to know the types of transactions which are covered by the Rule because as John Chipman Gray once said, the Rule is to be remorselessly applied to void interests which vest or fail to vest within a life in being plus twenty one years. The author gives the oil and gas attorney a short historical view of the development of the Rule, followed by the generally accepted reasons that underlie the Rule's long life. The author then analyzes the major types of transactions which have run into Rule difficulties. Finally, the author suggests that while a number of authorities have argued that the Rule should not apply to 'commercial' transactions, such as many oil and gas transactions, he concludes that the Rule should be applied in those situations where the purpose of the Rule in preventing remotely vesting interests from taking mineral estates out of the stream of commerce will be achieved.

I. THE RULE AGAINST PERPETUITIES

As every first year law student knows, Professor John Chipman Gray provided the classic statement of the Rule Against Perpetuities (hereinafter the Rule): “No interest is good unless it must vest, if at all, not later than twenty-one years after some life in being at the creation of the interest.”¹ It reflects, along with a number of other property rules, a clash

between the landed interests and the courts regarding the free alienability of land.\textsuperscript{2} Prior to the Duke of Norfolk’s Case in 1681,\textsuperscript{3} court decisions almost always tended to make land more alienable and restricted the ability of the landed families to restrict future generations in their use and alienation of the land.\textsuperscript{4} What probably triggered the development of the Rule was the court’s acceptance of two types of indestructible future interests, namely the executory interest and the shifting use.\textsuperscript{5}

In a decision reminiscent of recent Ping-Pong decisions of the Texas Supreme Court,\textsuperscript{6} Lord Chancellor Nottingham was dealing with a trust indenture designed to protect a landed family from the consequences of the insanity of the oldest son of the patriarch of the family. As summarized by Professor Gray, the land was conveyed to trustees for a long term for B, the second son and the heirs of his body, but if A, the oldest son, should die without male issue during the life of B, or if the title should descend to B, the trust was to be for the benefit of C, a third son. A died without issue in the life of B. The issue was whether the shifting executory interest to C was valid.\textsuperscript{7} Nottingham was sensitive of the desires of the patriarch to deal with the problems insofar as his living relatives were concerned. But in discussing the ability of the patriarch to control future interests which had recently been found to be indestructible, the Lord Chancellor said:

Now the ultimus quod sit, or the utmost limitation of a fee upon a fee, is not plainly determined, but it will be soon found out, if men shall set their wits on work to contrive by contingencies, to do that which the law has so long labored

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\item \textsuperscript{2} RICHARD R. POWELL & PATRICK J. ROHAN, POWELL ON REAL PROPERTY ¶ 759 (1996).
\item \textsuperscript{3} Duke of Norfolk’s Case, 3 Ch.Cas. 1, 22 ENG. REP. 931 (Ch. 1681).
\item \textsuperscript{4} For example in D’Arundel’s Case, Bracton NB 1054 (1225) the term “and his heirs” was treated as words of limitation, not words of purchase so that the hereditament could be transferred without the consent of the heirs.
\item \textsuperscript{5} Both of these interests are now called executory interests. Manning’s Case, 8 Co. Rep. 94b, 77 ENG. REP. 618 (KB 1609) sustained an executory interest in a chattel real while Pells v. Brown, Cro. Jac. 590, 79 ENG. REP. 504 (1620) sustained the validity of a shifting use. See generally, David A. Thomas (ed.), Thompson on Real Property, § 28.01 (1994).
\item \textsuperscript{6} See generally, POWELL & ROHAN, supra note 2, ¶ 760 [2]. The original opinion was given by Lord Chancellor Nottingham in January, 1681. Three distinguished justices opposed Nottingham’s opinion and a rehearing was granted. Again there was a disagreement with Nottingham continuing to adhere to his original opinion. Shortly after the rehearing, however, Nottingham died and was replaced as Lord Chancellor by the former Lord Chief Justice North who had disagreed with Nottingham’s decision. The Nottingham decision was reversed. Appeal to the House of Lords was delayed until 1685. North presided over the hearing where he was opposed by Lord Chief Justice Jeffreys, a long-time and ardent opponent. Jeffreys apparently carried the day and persuaded the House of Lords to reinstate the Nottingham opinion over North’s strong objection. Herbert Barry, The Duke of Norfolk’s Case, 23 VA. L. REV. 538 (1937).
\item \textsuperscript{7} See GRAY, RULE AGAINST PERPETUITIES, supra note 1, § 169.
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against, the thing will make itself evident, where it is inconvenient, and God forbid, but that mischief should be obviated and prevented.\(^8\)

This mischief or inconvenience was referred to as a perpetuity which would only be valid if the contingency or limitation was to occur or not occur within a life in being. Since the transfer to \(C\) would occur or not occur upon the death of \(A\) and \(B\), both lives in being, the transfer was found to be valid.

After a series of cases spanning some 150 years, the most important being Thellusson v. Woodford,\(^9\) the generally accepted present day concept of a life in being plus 21 years plus a period of gestation was developed. It also became clear that the courts were greatly concerned with the effect on alienability in their decisions creating the life in being plus 21 years limit. The House of Lords in Thellusson said:

But when the true reason for circumscribing the period, during which alienation may be suspended, is adverted to, there seems to be no ground or principle, that renders such an ingredient necessary. The principle is the avoiding of a public evil by placing property for too great a time out of commerce. The length of time will not be greater or less, whether the lives taken have any interest vested or contingent, or have not.\(^10\)

This concern with alienability or "inconvenient fettering" cannot be said to have been one that has existed since the beginning of common law property principles.\(^11\) After all, the statute De Donis Conditionalibus which was enacted in 1285 stood for almost 200 years as authorizing the creation of a fee tail estate in perpetuity.\(^12\) The common law courts did little to ameliorate the fettering of estates in land which undoubtedly greatly restricted the efficient use of land.

Recent commentators and historians of the Rule have developed a more complex series of societal reasons for the Rule's staying power over

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10. *Powell & Rohan*, supra note 2, ¶ 762 [2] n.13. The court also announced: "The rule allowing any number of lives in being, a reasonable time for gestation, and twenty-one years, is now the clear law, that has been settled and followed for ages; and we cannot shake that rule without shaking the foundations of the law." 4 Vesey 319 (Ch. 1798).
11. *Restatement of Property* 2129 (1944) suggests that "courts have manifested strong belief in the importance to society of imposing restrictions upon attempted fetterings of property." The Second Restatement, however, notes that after De Donis the courts were not necessarily wedded to a notion of free alienability. *Restatement (Second) of Property: Donative Transfers* 6 (1983).
the years. The First Restatement of Property identified the following three purposes of the Rule:

the rule against perpetuities provides an adjustment or balance between the desire of the current owner of property to prolong indefinitely into the future his control over the devolution and use thereof and the desire of the person who will in the future become the owner of the affected land or other thing, to be free from the dead hand.

In the second place, the rule against perpetuities contributes to the probable utilization of the wealth of society. This contribution is made in two different ways. By prohibiting certain categories of uncertain future interests, this rule minimizes the fear of loss of investment normally felt by the owner of a present interest subject to an outstanding future interest. The rule against perpetuities facilitates the utilization of the wealth of society in still another way, as a means “for forwarding the circulation of property.” This it does by prohibiting those categories of future interests which would make either impossible or improbable, sales of land for long periods of time.

In the third place, the rule against perpetuities aids in the keeping of property responsive to the meeting of the exigencies of its current owners. The division of ownership into successive interests tends to lessen the sum realizable upon a sale of the separated interests, and thus diminishes the total purchasing power of the wealth represented by the thing in which such divided interests have been created. \(^{13}\)

It is against this background that the Rule must be analyzed where oil and gas transactions are concerned. Oil and gas jurisprudence has gained much from its inclusion within the pantheon of property law.\(^{14}\) While courts have struggled with, and on occasion ignored, the application of the Rule to certain types of oil and gas transactions, it is the rare court which throws off the yoke of 375 years of common law Rule developments

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13. RESTATEMENT OF PROPERTY, supra note 11, at 2129-31. Similar purposes were attributed to the Rule by Professor Casner who was the reporter of the Restatement (Second) of Property. He stated: “From this review of diverse purposes served by the rule against perpetuities, it is fair to conclude that the social interest in preserving property from excessive interference with its alienability rests partly upon the necessities of maintaining a going society controlled primarily by its living members, partly upon the social desirability of facilitating the utilization of wealth, and partly upon the social desirability of keeping property responsive to the current exigencies of its current beneficial owners.” RESTATEMENT (SECOND) OF PROPERTY: DONATIVE TRANSFERS 10 (1983). See generally, Lewis Simes, The Policy Against Perpetuities, 103 U. PA. L. REV. 707 (1955).

and agrees with Professors Williams and Meyers that the Rule has no place in 'commercial' oil and gas disputes.\textsuperscript{15}

II. THE RULE AND OIL AND GAS TRANSACTIONS IN GENERAL

A. The Oil and Gas Lease

The present day oil and gas lease did not spring sui generis from the head of Medusa. As with most common law developments, the modern short primary term followed by an indefinite secondary term triggered by the production of oil or gas in paying quantities or by any number of consensual alternatives, evolved over an extended period of time.\textsuperscript{16} An early Pennsylvania decision raised a red flag for Rule concerns when it held that the title to an oil and gas lease was inchoate until such time as production was secured.\textsuperscript{17} Since the vesting of title would be postponed until discovery was achieved the then recently developed "no-term" lease which followed the initial fixed term leases might have fallen into the Rule trap. Since the "no-term" lease did not require production within any time frame at all, that combined with the notion that title did not vest until production was secured might have been interpreted as the creation of a springing executory interest which would run afoul of the Rule. But in a series of cases in the early 1900s the courts unanimously rejected the notion that title to an oil and gas lease does not vest immediately upon its creation, therefore obviating any Rule problem.\textsuperscript{18} West Virginia was particularly active in the jurisprudence rejecting the application of the Rule to the "no-term" lease.\textsuperscript{19} With the validity of the "no-term" lease firmly entrenched, it appears clear

\textsuperscript{15} Patrick Martin & Bruce Kramer, Williams & Meyers Oil and Gas Law § 325 (1996)[hereinafter Williams & Meyers]. See also, W. Barton Leach, Perpetuities in Perspective: Ending the Rule's Reign of Terror, 65 Harv. L. Rev. 721, 725-6 (1952)(where Professor Leach also railed against the application of the Rule to modern commercial transactions). See Nantt v. Puckett Energy Co., 382 N.W.2d 655 (N.D. 1986).

\textsuperscript{16} See generally, Leslie Moses, The Evolution and Development of the Oil and Gas Lease, 2 Inst. on Oil & Gas L. & Tax'n 1 (1951); A.W. Walker, The Nature of Property Interests Created by an Oil and Gas Lease in Texas, 7 Tex. L. Rev. 1 (1928).

\textsuperscript{17} Venture Oil Co. v. Fretts, 25 A. 732 (Pa. 1893).


that the modern lease is likewise insulated from Rule problems. While there may have been some doubt as to the inapplicability of the Rule to the primary/secondary term lease in Georgia at one time, a recent decision finding no Rule problem with a mining lease for a term of 50 years "and for such longer time after such term has ended as Said Minerals are Produced from the Leased Land" has resolved that doubt in favor of not applying the Rule.

B. Options To Renew Leases

The application of the Rule to options of indeterminate length dealing with the conveyance or reconveyance of an interest in real property has been the subject of substantial controversy. Professor Gray argued that the English precedents clearly applied the Rule to these types of options based on the fact that the option gave the owner an equitable interest in the real property. Some courts disdain the purist approach and apply a balancing approach to determine if the Rule's policy against the fettering the free use of property is outweighed by other considerations of public concern and welfare. But for the most part courts find that the Rule should be applied to options to purchase or re-purchase real property.

20. As one might expect there are no Rule cases dealing with the modern type of oil and gas lease. There was a mining lease with a similar short primary and secondary term feature where the court found that the lease did not violate the Rule. Aikens v. Nevada Placer, Inc., 13 P.2d 1103 (Nev. 1932).

21. The earlier decision, Brown v. Mathis, 41 S.E.2d 137 (Ga. 1947) found that a reservation of the right to mine sand, to be paid at the royalty rate of $.10/carload when removed violated the Rule because it was treated as an option to purchase in gross. The later decision, Parker v. Reynolds Metals Co., 747 F.Supp. 711 (M.D.Ga. 1990) upheld the 50 year primary term and so long thereafter as minerals are produced as being a perpetual lease, not a perpetual option.


24. See, e.g., Roundtree v. Richardson, 108 So.2d 152 (Ala. 1959); Mattern v. Herzog, 367 S.W.2d 312 (Tex. 1963); Skee v. Clinchfield Coal Corp., 119 S.E. 89 (Va. 1923). See also Greenshields v. Warren Petroleum Corp., 248 F.2d 61 (10th Cir.), cert denied, 355 U.S. 907 (1957). In Greenshields the application of the Rule to a gas purchase contract which entitled the buyer to all of the gas which may be produced or hereafter acquired by the seller was rejected. The assertion was that the reference to gas that may be acquired essentially gave the buyer an option which would not meet the Rule requirements. The court, relying in part on Oklahoma's status as a non-ownership jurisdiction, concluded that the Rule should not apply since the interest was vested when the contract was executed and would otherwise interfere with the development of oil and gas resources. Id.
Notwithstanding this general rule regarding options, a perpetual option to renew an oil and gas lease was found to be valid. Similar results were reached in the analogous situation of the "no-term" lease which gave the lessee the perpetual right to renew the lease through a rental payment. In Epstein v. Zahloute, the court in dictum found that a perpetual option to renew found in an oil and gas lease would not violate the rule because the oil and gas lease itself was an "estate in real property." The court attempted to distinguish perpetual options to renew in ordinary leases which it found void under the Rule. The distinction made by the Epstein court seems difficult to understand and might not apply in the many jurisdictions which apply the same doctrines and rules to oil and gas leases that they do for ordinary leases. Is there a difference between an ordinary lease giving the lessee the option to renew forever by the payment of the rental and an oil and gas lease providing for the same type of renewal. A Canadian court saw no difference and concluded that an option to renew an oil and gas lease was void for violating the Rule since it could be exercised for a period in excess of a life in being plus twenty-one years.

Although not involving an option to renew a lease, the recent Colorado Court of Appeals decision in Temple Hoyne Buell Foundation v. Holland & Hart, is instructive of the problems oil, gas and mineral conveyancers run into when they ignore the Rule. The defendant law firm represented the plaintiffs in connection with the sale of stock in Kings County Development Corp. (KCDC) to John Rocovich. The attorneys drafted an option contract as part of that transaction which allegedly gave the plaintiffs an option to purchase a portion of the mineral estate then owned by KCDC should KCDC ever distribute the mineral estate to its shareholders. KCDC instituted several lawsuits against various parties including the Foundation and Rocovich claiming they had breached their fiduciary duties to KCDC. The Foundation eventually settled with KCDC and agreed to receive only 1/2 of the mineral estate it would have been entitled to had the option contract been followed. KCDC had urged in the litigation that the option violated the Rule, but because the case was settled no definitive ruling had been reached. At that point the Foundation sued its former lawyers who drafted the option contract for legal malpractice.

The jury had found that the defendants had committed malpractice by creating an option that violated the Rule. The court of appeals

26. See cases cited supra, note 19.
30. Id. at 194.
disagreed, while noting that an option to purchase may under certain circumstances be subject to the Rule. Options will be subject to the Rule where they "fetter" the property interest which is the subject matter of the option for a period in violation of the Rule.\(^3\)1 Here there was no real property interest that was directly fettered by the option since Rocovich lacked any interest in the mineral estate until such time as the minerals were distributed to the shareholders. But even though the option was found not to violate the Rule, the defendant lawyers were not off the hook. The court said:

Thus, although we hold here that the option did not violate the Rule Against Perpetuities, the question remains whether defendants, as reasonably prudent attorneys, should have foreseen that the option, as drafted, was likely to result in litigation and whether other attorneys, in similar circumstances, would have taken steps to prevent such a result.\(^3\)2

Here the defendant attorney admitted that he had given no specific consideration to the Rule in drafting the agreement. Because factual issues existed regarding what the duty of a reasonable attorney would have been to at least research the Rule to see if it might apply, the court remanded the case back to the trial court for a second trial on the merits.\(^3\)3

C. Defeasible Term Interests

The defeasible term interest at first blush seems to be the "ugly duckling" of the mineral interest.\(^3\)4 Apparently favored by federal land banks unloading their previously foreclosed lands, these interests in the hands of a careless drafter may create significant Rule problems. A simple hypothetical shows the nature of the problem. Olga owns a fee simple absolute in the surface and mineral estate known as Techacre. She conveys the surface estate and 1/2 of the mineral estate to Alice in fee simple absolute. As to the other 1/2 mineral estate, Olga reserves them for herself for a period

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31. Id. at 195-96. See generally POWELL & ROHAN, supra note 2, ¶ 767B (1996).
32. Id. at 198.
33. The court clearly suggested, however, that an attorney would be guilty of malpractice if he "(a) did not research the issue of the Rule in the context of this transaction, (b) failed to consider the potential for a dispute over the applicability of the Rule to the option, and (c) failed to utilize a savings clause to protect against that potential dispute." 851 P.2d at 199. Thus merely because the attorney did not actually violate the Rule in the drafting of the instrument would not insulate him from a malpractice action if the plaintiff reasonably settled a potential dispute regarding the Rule and received less than he would have otherwise had not the dispute arisen.
34. For a more complete view of the Rule as it applies or does not apply to defeasible term interests, see Mangling, supra note 14, at 550-57.
of twenty years and so long thereafter as oil and gas is produced in paying quantities. Applying first year property principles, Olga has retained a fee simple subject to an executory limitation in the 1/2 mineral interests and has conveyed to Alice an executory interest. Alice's interest is an executory interest because it is a future interest created in someone other than the grantor that will become possessory by the divesting of a prior freehold estate held by another person. Since the executory interest may or may not vest or fail to vest within a life in being plus 21 years, the conveyance to Alice of a future interest in the 1/2 mineral interest should be void. That would lead to the anomalous result that Olga who purported to reserve something less than a fee simple absolute in the 1/2 mineral interest has reserved just such an interest.

Olga could have easily achieved her objective of reserving a defeasible term interest by utilizing two instruments. If she would have conveyed the entire fee simple absolute to Alice and then have Alice re-convey back to her the 20 year plus production mineral interest no Rule problem would have arisen. That is because the interest created in Olga by the Alice/Olga deed is a fee simple determinable with Alice reserving a possibility of reverter. As we all know, while a possibility of reverter is a contingent future interest, it is for historically anomalous reasons not subject to the Rule. Yet courts have in recent times come to the rescue of grantors, grantees and their attorneys who fail to use the double deed method to protect themselves against the Rule.

The early cases, however, were not so kind to the drafters. In an analogous non-oil and gas case, the New York Court of Appeals concluded that a grantor who conveyed the surface estate but who reserved a certain plot and lime kiln for "so long as said lime kiln is occupied and used for the purpose of burning lime," had violated the Rule. This early case was followed by Victory Oil Co. v. Hancock Oil Co., where the grantor excepted and reserved all minerals "for a period of twenty (20) years, and so long thereafter as oil, gas or other minerals may or shall be produced therefrom in paying quantities." The California Supreme Court first concluded that its constitutional perpetuities provision was the equivalent of the common law Rule, since this grant had antedated the statutory adoption of the Rule. The court also rejected the modern approach of treating the grantor's interest as a reserved interest and thus subject to the common law regrant

35. See generally CORNELIUS MOYNIHAN, INTRODUCTION TO THE LAW OF REAL PROPERTY 178-80, 190-92 (2d ed. 1988).
36. LEWIS SIMES & ALLAN F. SMITH, THE LAW OF FUTURE INTERESTS §§ 1236, 1239 (2d ed. 1956); THOMAS E. ATKINSON, ET AL. AMERICAN LAW OF PROPERTY § 24.1 at 7 n.3 (1952).
39. Id. at 606-7.
fiction. While criticized by some leading authorities, it is clear that the court's lengthy discussion of the Rule and its application to the conveyed interest set forth a warning shot across the bow of the ship for those who ignored the Rule.

While Victory Oil placed California lawyers on notice about potential Rule problems, the California Supreme Court less than four years later muddied the waters in Brown v. Terra Bella Irrigation District. In Brown the grantor reserved the minerals "for a period of 25 years and as long thereafter as oil or gas or petroleum products or minerals shall be produced from said property in paying quantities." There was an additional clause that created some confusion. That clause said:

Subject to the reservations and conditions aforesaid, [grantor] hereby grants, bargains, sells and conveys all of said real property aforesaid, to the [grantee], together with the tenements, hereditaments, and appurtenances thereunto belonging or appertaining, and the reversions, remainder and remainders, rents, issues, and profits thereof.

This strange sounding legalese confounded the Supreme Court so that they did not apply the Victory Oil rationale to invalidate what was clearly a springing executory interest. If the Rule invalidated that executory interest in the grantee, it would return to the grantor, only to be instantaneously transferred back to the grantee by virtue of this strangely worded paragraph. The court's use or misuse of the terms possibility of reverter, reversion and remainder make the decision difficult to understand at best. The court's conclusion that the grantor intended to convey all of his reversionary rights to the grantee flies in the face of the express reservation of a fee simple subject to an executory limitation. As Professor Williams noted: "In the present state of the law, in California and elsewhere, the careful conveyancer will avoid conveying interests subject to reserved defeasible term interests."

Given the choice between Victory Oil and Brown a California court of appeals chose the Brown approach notwithstanding the grantor's express

42. 330 P.2d 775 (Cal. 1958).
43. Id. at 776.
44. Id.
45. The court inexplicably did not cite Victory Oil leaving readers in the dark as to its continued vitality given the diametrically opposite result.
46. WILLIAMS AND MEYERS, supra note 15, § 186.4.
assertion of the controlling authority of Victory Oil. In Rousselot v. Spanier, the grantors reserved to themselves the oil and gas except it would lapse if production wasn’t achieved within 20 years and continuing thereafter. The grantors asserted that the grantees received an executory interest that violated the Rule. The court relied on the distinction between ownership and non-ownership jurisdictions, namely that the oil and gas estate in California is a profit a prendre or an incorporeal hereditament. Incorporeal hereditaments are not estates in land. They are burdens on the corporeal or possessory estate. Thus the grantor conveyed the full possessory estate to the grantee, burdened by the grantor’s non-possessory estate. The grantee’s interest was vested at the time the interest was created.

This use of the corporeal/incorporeal distinction to deny the existence of common law estates in land which would be subject to the Rule, has some support in Gerhard v. Stephens, although courts in non-ownership jurisdictions have for many years attached the estate labels to the mineral estate and oil and gas lease.

The Rousselot approach would obviously not work in an ownership jurisdiction which treats the mineral interest as a corporeal hereditament. Several courts have applied the fictional regrant theory that applies to reservations to find that the Rule has not been violated where the grantor reserves the present possessory estate. The fiction operates as follows: Historically courts treated reservations and exceptions differently. Exceptions were never part of the grant while a reservation granted all of the interest to the grantees with a fictional re-grant back to the grantor. Thus if a defeasible term mineral interest is reserved and not excepted the full mineral estate is conveyed to the grantee who then transfers back to the grantor the fee simple determinable while retaining for the grantee a possibility of reverter.

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47. 131 Cal. Rptr. 438 (Cal. App. 1976). See also Stevens Mineral Co. v. State of Michigan, 418 N.W.2d 130 (Mich. App. 1987), lv.app.den., 430 Mich. 896 (1988) where the court also did not apply the Rule since it treated the defeasible term mineral interest as a profit a prendre so that the granted interest in the land and minerals vested at the time the deed was executed.

48. 131 Cal. Rptr. at 439. The court said: “The interest granted to [the grantee] was a present possessory interest. When the grantor’s interest ceases because oil and gas are no longer found in paying quantities, the grantees are left with their estate free of that burden. The expiration of the profit a prendre does not create a new estate in violation of the rule against perpetuities.” Id. [footnotes omitted].

49. 442 P.2d 692 (Cal. 1968).


There are many problems with this fictional re-grant theory. An initial problem is the use of a fiction to reach a result that would otherwise be barred by the Rule.\(^{53}\) The other problem is discerning whether the grantor excepted or reserved the defeasible term interest since most modern deed forms use both terms in describing what the grantor is doing. The Alabama Supreme Court was particularly frank about this intent question when it stated:

Realistically, [the grantor] had no intent regarding any distinction between withholding an interest and receiving the same interest from his grantee. He would simply have intended to convey the property while retaining limited mineral rights by whatever form of words the lawyers said would be effective.\(^{54}\)

Notwithstanding that frank expression the court went on to identify several factors which led the court to conclude that a reservation and not an exception was intended.\(^{55}\) The Texas court which applied the same fictional re-grant approach also applied some canons of construction to support its interpretation. The Texas court stated:

The rule against perpetuities is a rule of property and not one of construction. However, the interpretation of a written instrument or instruments is ordinarily required for application of the rule. Where the instrument is capable of two constructions, one of which will give effect to the whole of the instrument, while the other would defeat it in whole or in part, preference is given to the construction that will uphold the instrument.\(^{56}\)

While the canon of construction that prefers an interpretation that gives effect to the intent of the parties is generally accepted, it must be remembered, as the court did, that the Rule is a rule of property which by its very nature is intent-defeating. In addition the use of a legal fiction is not a canon of construction but a substitute for the written language of the instrument created by the court to achieve a result that would otherwise not occur.

The difficulty that the Alabama and Texas courts encountered where the deed uses both “except” and “reserve” language was overcome

53. Mangling, supra note 14, at 556. “Creating a legal fiction takes something away from the law by creating an image of outcome-oriented decisions, rather than a careful analysis of the issues and rules raised by a particular common law doctrine.” Id.
54. International Paper Co., 429 So.2d at 993.
56. Bagby, 627 S.W.2d at 194.
in Walker v. Foss. In 1946 Adams conveyed various parcels of land to her 4 children, excepting and reserving to herself all of the oil and gas for a period for five years after her death and so long thereafter as oil and gas was produced in paying quantities. A dispute arose later, after various mesne conveyances, as to the nature of the estate that had been conveyed to the children.

In construing the deeds to the children the court found that the language contained therein was virtually identical to the deed language construed in Bagby. It agreed with the rationale of Bagby, although it did not go through the intricate analysis of whether the grantor really intended to reserve rather than except the present possessory interest, implying that if you apply the legal fiction you don't have to go over constructional hurdles in order to have that fiction applied. Where the court confused the issue was where it attempted to describe the nature of the interests created by this instrument. As noted above, the Bagby legal fiction transforms a springing executory interest in the grantee into a possibility of reverter. But this court clearly labels the interest received by the grantee as a springing executory interest. It then stated:

We recognize that the Bagby court characterized the future interest created by the grantor's reservation of a defeasible term interest as a possibility of reverter instead of terming it a springing executory interest to sidestep the effect of the rule against perpetuities. Although the rule against perpetuities is not directly at issue here, the [Bagby] court has delineated the interests created by reservation of a defeasible term interest.

Then the court states that the grantor reserved "an income stream to herself from the oil and gas underlying the property deeded . . . leaving him with a reversionary interest which vested in interest at the time the

58. The exact language of the deed provided that in addition to a life estate in the surface reserved by the mother she:

further excepted and reserved to the grantor herein, her heirs, devisees and assigns, all of the oil and gas (but not including any other minerals) in and under the said premises conveyed . . . the reservation of oil and gas . . . shall expire at the end of five years from and after the death of the grantor herein if at that time no oil and gas is being produced from any portion of said land in paying quantities. If oil and gas is being produced in paying quantities at the end of five years from the death of the grantor, then this reservation shall expire when said production in paying quantities shall cease. At the time of the expiration of this reservation . . . all of said oil and gas not theretofore removed and all said rights appurtenant thereto shall vest in the above named grantee and his heirs and assigns.
59. 930 S.W.2d at 705 n. 2.
deed was executed.  "60 How a court can label an interest created in someone other than the grantor as a reversionary interest is hard to understand. By also characterizing the grantor's reservation of an income stream, rather than the mineral estate, the court suggests that no property interest in the oil and gas was reserved, yet it is clear that is what the deed purports to do. The grantor owned the mineral estate and could have leased or developed it at any time during her lifetime. In addition, her heirs could have leased or developed the oil and gas up to five years after she died. The interest created in the grantees is either a springing executory interest which is void under the Rule, or is a possibility of reverter by application of the legal fiction. It can't be a springing executory interest which vests at the time of creation because executory interests do not vest until the conditions have been satisfied.

The Rule was also ignored by the Wyoming Supreme Court which did the greatest violence to common law estates doctrine when it found that the interest created in the grantee following a defeasible fee simple was a vested remainder and not an executory interest. 61 The concurring judge would have exempted the executory interests created by the defeasible term interest from the application of the Rule by following the Williams & Meyers suggestion that the Rule should not apply to certain oil and gas transactions which serve the social and commercial convenience. 62

The vast majority of litigation, however, has largely ignored the Rule problems inherent in the reservation of a defeasible term interest. 63 For example, in McLaurin v. Royalties, Inc., 64 the court completely ignores the Rule problem even though the defeasible term deed was critical to the determination of the ownership of the minerals. In other cases the court mistakenly labels the future interest in the grantee as a possibility of reverter, rather than an executory interest. 65

The practical results of almost all of these cases is that the courts have refused to follow the traditional doctrines relating to estates in land in order to apply the Rule to a situation where it is clearly called for. The

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60. Id.
62. 668 P.2d at 638 (Thomas, J., concurring) Justice Thomas also would have applied the "wait and see" doctrine to determine the validity of the executory interest and if the defeasible term did not actually last for a period of time in excess of a life in being plus 21 years, it would be valid. Since there was no production within the 20 year term period, the executory interest did actually vest within the Rule period. 668 P.2d at 633-34.
63. See cases cited in WILLIAMS & MEYERS, supra note 15, at 186.2(2) n.8.
64. 95 So.2d 105 (Miss. 1957).
courts have accepted the following rationale proffered by Howard Williams:

We believe that defeasible term interests serve a useful social purpose, whether reserved or granted. The term interest, as compared with a perpetual interest, tends to remove title complications when the land is no longer productive of oil or gas. This simplification of title promotes alienability of land, which is one purpose served by the Rule against Perpetuities. We believe, therefore, that the courts should simply exempt interests following granted or reserved defeasible term interests from the Rule, on the straight-forward basis that they serve social and commercial convenience and do not offend the policy of the Rule Against Perpetuities.66

I disagree with the wholesale exemption for deeds which fail to comply with the Rule merely because oil and gas interests are the subject of the conveyance. Should there be an exemption for defeasible term deeds of surface estates from the Rule? I think not. The 'hypertechnical' rule that allows the parties to achieve the same result through the use of two deeds should not serve as the basis for a wholesale exemption of the Rule.67

D. Royalty Interests

Oscar is the fee simple absolute owner of Raideracre. He leases to Lobo Oil reserving a $\frac{1}{6}$th royalty. Shortly thereafter Oscar transfers to Alexis the all of his interests except for the following reservation:

It is particularly agreed, and this conveyance is made subject thereto, and said reservation and the terms and stipulations hereof relative thereto, that Alexis, its successors and assigns shall receive and be entitled to one-half the royalties payable thereunder, and all of the reversionary rights in the minerals, except that there is hereby reserved to Oscar, one-half ($\frac{1}{2}$) of all royalties accruing and/or payable under the existing leases, and, in the event of the termination, forfeiture or expiration of said leases, as and when same may, respectively, so terminate, forfeit, or expire, a perpetual non-participating free royalty interest in and to all the minerals, in,

67. Id. where the authors find the law not only hypertechnical but foolish as well for allowing two deeds to achieve what one deed cannot. I do not believe that it is any more foolish than the courts which apply the legal fiction relating to reservations to save a transaction from the malpractice lawyers.
upon, or under the lands conveyed hereby as follows: \( \frac{1}{16} \)th on oil and gas.\(^{68}\)

Does the reserved royalty interest that burdens future production violate the Rule Against Perpetuities? The answer to that question may depend on which state law you apply.\(^{69}\) A recent case arising in Texas dealt with the argument that the royalty reservation relating to future production violated the Rule because the future royalty could not become effective until the existing leases terminated and since those leases could extend for a period in excess of that allowed by the Rule, the interests were void.\(^{70}\) In most states, including Texas, this argument fundamentally misconstrues the nature of a royalty interest created outside of the oil and gas leasing transaction.

A royalty interest is a fractional share of production free of the expenses of production which may be created independent of a lease.\(^{71}\) It is a part of the mineral interest which unless otherwise reserved is conveyed with the mineral estate. The duration of a royalty interest may be in fee simple absolute or any of the other recognized estates in land, including a fixed term for years.\(^{72}\) Regardless of the estate being transferred in ‘future’ royalties, a number of jurisdictions have treated such transfers as violating the Rule based on the erroneous assumption that a royalty interest is only vested when production occurs.

The leading state that has adopted this misconception is Kansas. Their slide down the slippery slope began with dictum in Miller v. Sooy,\(^{73}\) that a conveyance of a royalty interest from production from leases not yet in existence would violate the Rule. Since the court had previously found that the conveyance of a royalty interest was limited to the individual grantee, and not his heirs or assigns, that conclusion was clearly irrelevant to the outcome of the litigation. Nonetheless, the dictum was approved by the Kansas Supreme Court some 25 years later in Lathrop v. Eyestone.\(^{74}\) The grantor had previously executed an oil and gas lease on the parcel in

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68. The language cited is contained in the deed interpreted by the court in Hamman v. Bright & Co., 924 S.W.2d 168, 174 (Tex.App. 1996), judg. vacated in aid of settlement, 938 S.W.2d 718 (Tex. 1997).
70. Hamman, 924 S.W.2d at 175.
73. 242 P. 140 (Kan. 1926).
74. 227 P.2d 136 (Kan. 1951).
question. Through two separate instruments the grantor purposed to convey fractional interests in the existing lease and in the bonus and royalty that would occur under any future lease. The grantor also expressly reserved the executive power to lease. The grantor conveyed his reserved interest to the plaintiff who brought a quiet title action, asserting that the grantee’s royalty interest from future leases violated the rule. The court concluded:

Appellant or future fee owners might never execute another lease. There is nothing in any of the instruments which imposes a duty on them to do so. Moreover there is no limitation of time within which a future lease would be required to be executed. It is, therefore, wholly problematical when, if ever, such an interest under future leases would vest. Such a grant violates the rule against perpetuities, a rule against too remote vesting.\(^{75}\)

This ignores the fact that a royalty interest is a vested interest. The Rule only applies to contingent remainders and executory interests. The free-standing royalty interest or the royalty interest that applies to future leases is a vested interest when it is created. It is not a contingent future interest because production might not occur for an indefinite period of time. Nonetheless, Lathrop continues to be followed in Kansas,\(^{76}\) although some

75. Id. at 143-44.

76. Cosgrove v. Young, 642 P.2d 75 (Kan. 1982). See also David Pierce, Kansas Oil & Gas Handbook, §§ 4.15, 4.16 (1986) and Drach v. Ely, 703 P.2d 746 (Kan. 1985). A recent decision suggests that Kansas courts are still struggling with the vesting concept of Lathrop. In Fritschen v. Wanek, 924 P.2d 1288 (Kan. App. 1996) the testator in his will devised to his children “an undivided one-sixty-fourth of all the Oil, Gas and other Minerals produced and saved from the following described land prior to May 26, 1951.” Id. at 1289. In 1941 the children executed a family settlement agreement extending the grant “until April 21, 1956, and as long thereafter as oil or gas is continuously produced from these premises or any portion thereof or said property is being continuously developed and operated.” Id. at 1291. When the will was admitted to probate and when the agreement was executed there was no production. Under the Lathrop view that royalty interests do not vest until there is production, one might think that these interests would violate the Rule. The court did not focus on the issue of what was the latest period of time in which the royalty interests would vest or fail to vest. As written the will specified a termination date within 21 years of its becoming effective and the settlement agreement had a similar limitation. Thus, the royalty interest would have vested or failed to vest within 21 years of a life in being since production would have to occur prior to 1956 in order to extend the interest indefinitely. Instead the court focused on a constructional preference to avoid Rule problems contained in Gore v. Beren, 254 Kan. 418, 428-29, 867 P.2d 330 (1994) and a dislike for applying the Rule to modern business practices. What is also interesting is that the court did not mention the fact that Kansas has adopted the Uniform Statutory Rule Against Perpetuities which changes the time period in which an interest must vest or fail to vest. Kan.Stat.Ann. § 59-3401 et seq.
later cases have raised some doubts as to continuing vitality.77

In California, an early case suggested that the reservation of a free-standing royalty interest payable out of future lease production would violate the Rule. In *Dallapi v. Campbell*,78 the grantor had reserved the executive power and the right to distribute royalties at a time when there were no existing leases. The court did not discuss the validity of the royalty reservation, but focused on the reservation of the executive power. Here the court concluded that the reservation for an indefinite period of time of the executive power violated the Rule.79 If you treat the executive power as a non-vested interest until it is exercised, you are applying the same analysis as *Lathrop*. Thus for a number of years, there was a substantial question as to whether one could create a free-standing royalty interest in California. But in *Keville v. Hollister Co.*,80 the court determined that the executive power vested when it becomes exercisable, not when it is actually exercised.81 Thus the Rule would not apply since the interests were vested. Applying that rationale to the royalty situation would lead to a similar result, the royalty interest was vested when created, not when there was actual oil and gas production.

The leading decision that firmly rejects the Kansas approach to royalty interests is *Hanson v. Ware*.82 The deed purported to transfer a 1/4th royalty interest in the existing lease and from whomever shall operate the premises in question. The court noted both the Kansas and California decisions before rejecting them as not persuasive. The court concluded:

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77. See, e.g., *Froelich v. United Royalty Co.*, 290 P.2d 93 (Kan. 1955), on rehearing, 297 P.2d 1106 (Kan. 1956). Froelich involved a grant of one-half of the royalty which may be reserved by the grantor. Grantor had the exclusive executive power to lease. The term of the grant was for 21 years and so long thereafter as oil or gas was produced in paying quantities.
The court concluded that the grantee's interest was vested and therefore the Rule did not apply, even though *Lathrop* clearly would have found the royalty interest subject to the Rule. *Id.* at 98.

78. 114 P.2d 646 (1941).


80. 105 Cal. Rptr. 238 (1972).

81. *Id.* at 239-40.

We are decidedly of the opinion that the rule against perpetuities was not violated by the conveyance for the reason that they acquired a present interest rather than a future interest in the land. To treat the appellees’ royalty as a future interest involves a failure to distinguish between their estate in real property, which is an abstract legal conception, and the likelihood of their ultimately receiving a share in the production of oil and gas, which is purely a practical matter.

It is plain, that under out law, the appellees acquired an estate in land at the moment they received the deed in question. That estate was one of absolute ownership, although limited in extent In short, the typical contingent remainderman has an uncertain interest in the fee simple, while these appellees have a fee simple interest in the uncertain.\(^83\)

The key distinction between the vesting of an estate and receiving the fruits of the royalty clearly places the free-standing royalty interest outside of the strictures of the Rule.\(^84\)

It was therefore somewhat surprising when in _Hamman v. Bright & Co._,\(^85\) a party asserted that the royalty interest reserved using language similar to that given at the beginning of this section violated the Rule. Their argument was based on an extrapolation from _Peveto v. Starkey_,\(^86\) which had concluded that the transfer of a royalty interest which was to become effective upon the expiration of a subsisting defeasible term royalty interest violated the Rule. In the usual case, the transfer of a royalty interest held by a lessor that applies to future leases or production is a transfer of a portion of the lessor’s possibility of reverter. That future interest is transferable inter vivos under modern conveyancing doctrine and the owner of the possibility of reverter is free to divide up the bundle of sticks that make up the future interest just as she can divide up the bundle of sticks that make up the present possessory mineral estate. The transfer by a lessor of a royalty interest in future leases is a present transfer of a future interest. There is no

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83. 274 S.W.2d at 362.
84. The vast majority of cases dealing with either the executive power or the free-standing royalty have presumed that the interest is valid without discussing the Rule. See, e.g., Davis v. Mann, 234 F.2d 553 (10th Cir. 1956)(applying Oklahoma law); Texas Gulf Producing Co. v. Griffith, 65 So. 2d 834 (Miss. 1953); Duval v. Stone, 213 P.2d 212 (1949); Watkins v. Slaughter, 189 S.W.2d 699 (1945). For an interesting case dealing with the transfer of a royalty interest to a royalty pool for a period of ten years and so long thereafter as oil or gas is produced on any of the pooled tracts, see Moffitt v. Sederlund, 378 N.W.2d 491 (Mich. App. 1985)(finding Rule not applicable).
85. 924 S.W.2d 168 (Tex. App. 1996), judg. vacated in aid of settlement, 938 S.W. 2d 718 (Tex. 1997).
86. 645 S.W.2d 770 (Tex. 1982).
condition precedent to the royalty interest vesting. It is vested at the time of conveyance, not at the time the extant lease expires and a future lease is executed.  

E. Joint Operating Agreements

There are several circumstances where the Rule may apply to a typical joint operating agreement (JOA). One involves the provisions of a JOA that allow a party to go non-consent. One way of structuring the non-consent provision involves an express or implied conveyance of the carried interest to the operating parties with a promise or covenant to reconvey the interest after the well attains pay-out of both the production costs and the non-consent penalty. The difficulty arises because the promise to reconvey the interest is specifically enforceable. Historically, where a contract "raises an equitable right in property which the obligee can enforce in chancery by a decree for specific performance, such equitable right is subject to the Rule Against Perpetuities." Since the well may never achieve production sufficient to cover costs and the non-consent penalty, the promise to reconvey would not be specifically enforceable unless it occurred within the Rule's life in being plus twenty-one years. Rather than treating this type of carried interest as a conveyance and a reconveyance, Dean Kuntz would treat the arrangement as the creation of a valid charge or lien on the carried party's interest.

The second problem area for JOAs arises because typically an option to purchase an interest in real property is subject to the Rule. Most JOAs contain a provision, commonly referred to as a "preferential right to purchase" which gives each of the signatory parties the right to purchase from another party, their interest in the property, if they want to sell or

87. The court in denying a motion for rehearing concluded: "There is no language conditioning the effectiveness of the reservation upon an uncertain future event 'Since the deed makes a present conveyance of the possibility of reverter, there is no violation of the rule against perpetuities. In particular, the deed did not condition the effectiveness of the grant on the expiration of the Coe lease.'" 924 S.W.2d at 175, citing Luckel v. White, 819 S.W.2d 459, 464 (Tex. 1991). See also Jupiter Oil Co. v. Snow, 819 S.W.2d 466 (Tex. 1991).


89. Gray Rule Against Perpetuities, supra note 1, at § 330.


91. Gray Rule Against Perpetuities, supra note 1, at § 330. The application of the Rule to options was clearly set forth in London & South Western R. Co. v. Gomm, 20 Ch. D. 562 (1882)(which overruled Birmingham Canal Co. v. Cartwright, 11 Ch. D. 421 (1879)).
convey that interest to a third party. One early case that suggested that certain types of options relating to oil and gas leases would fall outside of the Rule was Weber v. Texas Co. The lessee was given the right to purchase the lessor's royalty interest by matching the price offered by a third party. The lessor asserted that since the lease could last indefinitely, so could the option or preferential right to purchase. Notwithstanding the fact that Texas has a constitutional prohibition against perpetuities, the court concluded that the option was not invalidated by the Rule. The court focused instead on the underlying objective of the Rule and the reason why that objective would not be achieved by invalidating the option to purchase the royalty interest. The court stated:

The underlying reason for and purpose of the rule is to avoid fettering real property with future interests dependent upon contingencies unduly remote which isolate the property and exclude it from commerce and development for long periods of time, thus working an indirect restraint upon alienation, which is regarded at common law as a public evil.

The option under consideration is within neither the purpose of nor the reason for the rule. This is not an exclusive option to the lessee to buy at a fixed price which may be exercised at some remote time beyond the limit of the Rule Against Perpetuities, meanwhile forestalling alienation. It amounts to no more than a continuing and preferred right to buy at the market price whenever the lessor desires to sell. This does not restrain free alienation by the lessor.

Because the court analogized the specialized option to purchase in Weber as a form of a preferential right to purchase, most early commentators on the subject did not feel that the Rule would invalidate the typical JOA preferential rights provision.

But a 1967 decision of the Oklahoma Supreme Court cast some doubt on the wholesale exemption of these preferential purchase rights. In Melcher v. Camp, the parties executed two related instruments, the first

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92. On preferential rights to purchase, see Harry M. Reasoner, Preferential Purchase Rights in Oil and Gas Instruments, 46 Tex. L. Rev. 57 (1967); Ryan M. Tew, Rights of First Refusal: The 'Options' That are Not Options, But May Become Options, 10 Eastern Min'L. Inst. Proc. 7-1 (1989).

93. 83 F.2d 807 (5th Cir.), cert. denied, 299 U.S. 561 (1936).

94. Tex. Const. art. I, § 26 provides: “Perpetuities and monopolies are contrary to the genius of a free government, and shall never be allowed, nor shall the law of primogeniture or entailments ever be enforced in the State.”

95. 83 F.2d at 808.


being a lease of the oil and gas above 5500 feet and the second giving the lessee of the shallow rights an option to purchase a lease of the deep rights should the lessor have any opportunity to lease such rights. The court treated the option to lease as being triggered by a contingency which may never occur, namely the receipt of an offer to lease the deep mineral rights. Oklahoma has both constitutional and statutory provisions that adopt the common law Rule.\textsuperscript{98} While admitting that the Rule does not apply to personal contracts which do not create or transfer any right of property, it does apply to contracts which create an interest in real property that may be specifically enforced. Distinguishing \textit{Weber} as an exception that has not been widely followed, the court determines that the preferential rights provision, much like its cousin the option to purchase, if exercisable for a period of time longer than the Rule allows will be invalidated.

A federal district court in Oklahoma faced with the \textit{Melcher} decision reluctantly applied the Rule to invalidate the preferential rights provision of a JOA.\textsuperscript{99} The court analyzed the problem as did the court in Weber, that the objectives of the Rule would not be achieved by its application to the JOA. The preferential rights provision does not fetter or clog alienation. It is in widespread use and many persons have relied on that provision. But because \textit{Melcher} rejected those same arguments in an analogous situation the court felt compelled to apply the Rule. The Oklahoma Supreme Court, however, was able to extricate the JOA from Rule invalidation after the Tenth Circuit certified a question to it after the district court's opinion was appealed. The Oklahoma Supreme Court found that the preferential rights provision while analytically similar to the option, is functionally distinguishable. An option is a classic Hohfeldian power. It gives the holder of the option the power to purchase the interest subject to the option regardless of the desires of the optionor. The preferential rights provision while also a Hohfeldian power is a much more limited power. In order to be exercised the optionor must first seek to sell the property interest to a third party. If the optionor decides to sell then she must give the holder of the preference right the power of first refusal. Alienation is thus not hindered because the owner of the interest subject to the preference right may choose to sell at any time. In addition the preference right only exists as long as the JOA is in existence, which is as long as the underlying leases survive. Thus a preference right limited to the duration of the underlying leases does not violate the Rule.\textsuperscript{100}


\textsuperscript{99} Producers Oil Co. v. Gore, 437 F.Supp. 737 (E.D. Okla. 1977), vacated and remanded 634 F.2d 487 (10th Cir. 1980) after certifying a question to the Oklahoma Supreme Court, 610 P.2d 772 (Okla. 1989).

\textsuperscript{100} 610 P.2d at 776 (citing Smith v. County of El Paso, 593 P.2d 979 (Colo. App. 1979)).
In choosing between \textit{Weber} and \textit{Melcher} most courts have followed Weber and refused to apply the Rule to preferential purchase rights provision whether contained in a JOA or other instrument.\textsuperscript{101} For example, in \textit{El Paso Production Co. v. PWG Partnership},\textsuperscript{102} the New Mexico Supreme Court construed an option to re-purchase a carried working interest as not violating the Rule. The grantors had conveyed their working interest in various federal oil and gas leases but had reserved the right to repurchase the leases for a cash payment of $25,000. The option could be exercised after a minimum of 30,000,000 MCF of gas was produced and upon the grantee achieving ‘pay-out’ on the original wells. Many years later successors in interest to the grantors argued that the repurchase right was not assignable because if it was assignable it would violate the Rule.\textsuperscript{103}

The court initially determined that the option to repurchase was assignable. It then tackled the issue of whether the Rule was violated since the conditions precedent to the exercise of the option were not certain to be complied with during the Rule's life in being plus 21 year period. The court identifies the purpose of the Rule as preventing the remote vesting of contingent future interest in real property.\textsuperscript{104} It follows \textit{Producers Oil} in finding that options to purchase the reversion at the end of or during the life of an underlying lease do not violate the Rule.\textsuperscript{105} The option to repurchase in this case was likely to occur or fail to occur within a reasonable amount of time giving the nature of reservoir dynamics. Where the option itself does not have a time limit, the courts will construe the language to infer a reasonable time limit or wait and see to determine if the interest will vest or fail to vest within the Rule period. In this case, both the inferred time period and the actual time for vesting would occur within the Rule period so that the Rule would not invalidate the option to repurchase the working interests.


\textsuperscript{102} 116 N.M. 583, 866 P.2d 311 (1993).

\textsuperscript{103} The grantors were seeking to avoid various involuntary sales of the interests in question which occurred because of the bankruptcy of one of the grantors. 866 P.2d at 314-15.


\textsuperscript{105} The court also noted that New Mexico by statute has adopted both the “wait and see” and “cy pres” approaches to avoiding Rule problems. N.M. STAT. ANN. § 45-2-901 (Repl. Pamp. 1995).
III. THE RULE AND TOP LEASES

A. Top Leases

Top leases have been defined as: "A lease granted by a landowner during the existence of a recorded mineral lease which is to become effective if and when the existing lease expires or is terminated." They have been used since the 1920s, notwithstanding the judicial statement that they are akin to "claimjumping." While there are two general categories of top leases, it is the top lease that is given to a third party that creates most of the problems. A top lease to the same lessee is, in effect, merely a lease extension or amendment, which, if agreed to by the parties, creates no Rule or other property problems.

The following were suggested as provisions that could be added to a regular lease which would effectively create a top lease:

It is recognized by lessor and lessee that lessor, or lessor's predecessor in interest, has heretofore executed an oil and gas lease dated, (the prior lease), covering the lands described herein. This lease is granted expressly subject to the existing rights, if any, held by the lessee (or lessee's successor in interest) under and by virtue of the prior lease.

This lease is made and entered into with the understanding and agreement that this lease is subject to that certain oil and gas lease dated, recorded in. This lease shall in no event interfere with said prior lease and lessee shall have no right of entry or possession for purposes of exercising lessee's rights hereunder during such time and only as long as such prior lease remains valid and subsisting under its own terms (but not any renewal or extension thereof) as to any lands covered hereby. Lessor represents and warrants that lessor has not entered into any renewal or agreement to renew said prior lease or amended said prior lease so as to extend the primary term as set forth or recorded therein.


107. For cases where the court discusses the existence of a top lease see Gypsy Oil Co. v. Marsh, 248 P. 329 (Okla. 1926); Rorex v. Karcher, 224 P. 696 (Okla. 1923); Texas Pacific Coal & Oil Co. v. Patton, 238 S.W. 202 (Tex.Comm'n App. 1922, judgmt. adopted).


109. Earnest, supra note 106, at 975-76.
Much of the language in these examples dealing with the delay in the enjoyment of the possessory right is traceable to the threat of lawsuits against top lessees by bottom lessees under a variety of legal theories.

One such theory involves the doctrine of obstruction. This doctrine prohibits the lessor from asserting that the existing lease has terminated or otherwise come to an end. One interpretation of a top lease is that the lessor has made an election to terminate the bottom lease and invest the top lessee with the possessory right. Thus the language of the top lease specifically denies the transfer of the present possessory right and makes the top lease subject to the bottom lease. In many situations, however, courts interpreted top leases as not constituting an obstruction of title either because the language of the top lease did not create such an obstruction or the bottom lessee has no actual or constructive knowledge of the top lease. The analogous doctrine of slander of title would also serve as an impediment to the execution of a top lease, although the bottom lessee would have to prove ‘malice’ in order to prevail. But an early decision which found that a top lease which was taken ‘subject to’ the bottom lease did not act as a declaration that the bottom lease was forfeited undoubtedly influenced drafters of top leases to include such conditional language, notwithstanding the potential problems such language may cause under the Rule. Today, top lessees need to be aware of the growth of the common law tort of tortious interference with contract.

116. For a general discussion of the tort as it is applied in Texas see R. Paul Yetter, From Texaco to CBS: Ten Years of Tortious Interference Issues, 14TH ANNUAL ADV. OIL, GAS & MIN’L. L. INST. Paper P (State Bar of Texas 1996). The tortious interference cause of action is not a recent development. See, e.g., Raymond v. Yarrington, 96 Tex. 443, 73 S.W. 800 (1904).
118. Yetter, supra note 116, at P-1.
B. The Cases

It is somewhat surprising that given the long history of top leases, that Rule questions did not appear earlier than they did. The first case to discuss the problem directly was *Stoltz, Wagner & Brown v. Duncan*.

Plaintiffs were top lessees who brought a quiet title action against the bottom lessees. Defendants argued that plaintiffs lacked standing to challenge their title to the leasehold estate because the top lease violated the Oklahoma Rule which is incorporated in their Constitution. By judicial decision, the constitutional provision is considered to have adopted the common law Rule. But Oklahoma has, by statute, adopted the cy pres rule as well as a rule to reform instruments that would otherwise violate the Rule. The language of the top leases in question said that they would become effective on a particular date or one year "from and after the expiration of the existing oil and gas lease, whichever is the later." As to the second of the time periods, the court concluded that it would violate the rule in the absence of an attempt to reform the language of the top lease. It was obvious that if the bottom lessee drilled a producing well within the remaining period of the primary term, that well could produce for a period in excess of a life in being plus twenty one years. Instead the court found that it would give effect to as much of the second proviso as possible. It did so by giving the top lessee not only the chance to possess the interest if the bottom lease terminated by the fixed date, but also for a period of one year following the fixed date. This gives the top lessee an opportunity to become the possessory owner within a period that fits within the Rule. The court also adopted a "wait and see" approach so that if the bottom lessee commenced the drilling of a well so as to extend the bottom lease’s primary term, the top lessee would still have an interest in the event that the well was completed as a dry hole within the one year period starting from the fixed date.

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120. OKLA. CONST. art. II, § 32 provides in part: "Perpetuities and monopolies are contrary to the genius of free government, and shall never be allowed." An identical provision is contained in the Texas Constitution. TEX. CONST. art. I, § 26.
122. OKLA. STAT. ANN., tit. 60, §§ 75-77.
123. 417 F.Supp. at 556.
124. Id. at 557. For an earlier case that is analogous to a top lease see Francis v. Superior Oil Co., 102 F.2d 732 (10th Cir. 1972). In Francis the lease was to begin from the date the "lessee may legally and peacefully enter upon and drill on said leased premises." Id. at 735. At the time that the lease was executed a municipal ordinance prevented the lessee from entering. The court, even in the absence of Rule savings statutes and doctrines, concluded
The next shot across the bow of persons drafting top leases, was not a top lease case, but a top royalty deed case, *Peveto v. Starkey.* 125 Jones conveyed a defeasible term royalty interest to Peveto that was to last for a period of fifteen years and so long thereafter as oil and gas was produced in paying quantities. Prior to the end of the 15 year fixed period Jones conveyed the same fractional royalty interest to Starkey using the following language: "This grant shall become effective only on the expiration of the above described Royalty Deed . . . dated April 23, 1960." 126 It was this conditional language, much like the conditional language used in top leases that triggers the concern about the Rule. Texas, like Oklahoma, has a constitutional perpetuities provision which is the equivalent of the common law Rule. 127 The court had two options available to it. The first is to invalidate the second top deed because it is a springing executory interest which may not vest or fail to vest within a life in being plus 21 years if production is occurring at the end of the fixed term. The second is to treat the top deed as a conveyance of a portion of the grantor’s possibility of reverter that was retained after the original grant of the defeasible term interest. The court chose the first interpretation based on the "effective only upon" language of the deed. That was a postponing of the vesting of the estate until such time as the first royalty interest expired. It was not the present conveyance of a portion of a possibility of reverter. Thus the executory interest in the second grantee is void.

The ramifications for top leases is evident. If a top lease uses conditional language or otherwise states that it only takes effect upon the termination of the bottom or base lease, the *Peveto* analysis would invalidate the top lease as a springing executory interest that violates the Rule. Shortly after *Peveto* was decided an Oklahoma court in dicta found that a top lease, unless it expired at the end of the fixed primary term of the bottom lease, would violate the Rule. 128 But *Peveto* did not have the general effect of

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126. 645 S.W.2d at 771.


forcing courts to either follow the Rule or construe around Rule problems when it came to top leases. Most courts continued to ignore the problem and deal with other matters relating to the construction and operation of top leases.\textsuperscript{129}

But in \textit{Hamman v. Bright & Co.},\textsuperscript{130} the court applied the Peveto rationale to invalidate a top lease while nonetheless stating that they were not deciding "whether all top lease violate the rule against perpetuities."\textsuperscript{131} The top leases contained the following language:

This lease shall be for a term... covering and embracing... ten (10) years after and subsequent to the forfeiture, or to the expiration, of said [bottom leases]...

It being particularly agreed and understood that during the existence and continuance of said prior lease that the rights, interests, estate, privileges and royalties, as fixed thereby, of said Lessors shall remain vested in and held and possessed by said Lessors, free of all claims and demands whatsoever by [the top lessee]...\textsuperscript{132}

Again the choice was between treating the transfer as a present (vested) conveyance of the lessor's possibility of reverter, or the transfer of a springing executory interest. While acknowledging that the lessor owned a possibility of reverter after the bottom leases, the court found that "under the express language of these top leases, they did not make present conveyances of their interests. Instead, the top leases conveyed interests that would vest in the grantee only upon termination of the bottom leases..."\textsuperscript{133} The court could have made a savings construction because the language of the top lease is certainly not crystal clear that what is being postponed is the vesting of the estate as opposed to the right of enjoyment of the estate. There appears to be no express condition precedent to the top lessee's interest becoming vested as might occur where the conditional language was clearer making the grant itself effective only upon the termination or forfeiture of the bottom lease. Nonetheless the court concluded that the lessor had attempted to convey a springing executory interest which violated the Rule and was therefore void. Thus the court followed the


\textsuperscript{130} 924 S.W.2d 168 (Tex. App. 1996), judg. vacated in aid of settlement, 938 S.W.2d 708 (Tex. 1997).

\textsuperscript{131} 924 S.W.2d at 173 n.4.

\textsuperscript{132} 924 S.W.2d at 172. The bottom lease covered some 20,000 acres, although at the time the top lease was executed to the son of the lessor, some 17,000 acres had been released. \textit{Reply Brief of Henry Hamman to Application for Writ of Error} 4 (on file with author).

\textsuperscript{133} 924 S.W.2d at 172-73.
dictum in Siniard and the logical extension of Peveto to invalidate a top lease.

Not every court has been so remorseless in their application of the Rule to top leases. In Nantt v. Puckett Energy Co., the effective date of the top lease was to be "the date[s] upon which the existing lease terminates, for whatever reason, and as to any or all of the lands contained therein. This lease shall run for a term of three (3) years from said effective date subject to the provisions contained in this lease." In addition the top lease said that it was to be subordinate to the bottom lease.

Notwithstanding the express condition that the bottom lease must terminate, the North Dakota Supreme Court found that the top lease did not violate a North Dakota statute which invalidates a suspension of the power of alienation for a period in excess of a life in being plus 21 years. Rejecting the dictum of Siniard, the court emphasizes the commercial utility of top leasing and its widespread acceptance within the industry. Relying on the Williams & Meyers principle that commercial transactions in oil and gas should not be held hostage to the Rule, the court combines a wait and see approach with a savings interpretation approach to uphold the validity of the interests created by a top lease. Since the bottom leases in this case expired at the end of their primary term, there would be no suspension of alienation for a lengthy period of time. Thus the underlying policy of the Rule and the statute would not be served by invalidating the top lease.

IV. CONCLUSION

The Rule Against Perpetuities, in its common law form, serves important public policy objectives. Because oil and gas law has developed as a sub-set of property law, some oil and gas transactions may run afoul of the Rule. The use of top leases is one such area where the Rule and the commercial practicalities of the oil and gas industry may collide. Should the owner of the possibility of reverter be able to transfer the interest prior to it becoming a possessory estate? Clearly the answer is yes. Should that same owner be able to transfer something less than the complete possibility of reverter? Again the answer should be yes. Should that owner be able to ignore the limitations contained in the Rule, either intentionally or by careless drafting? The answer is no. The certainty and security gained by


135. 382 N.W.2d at 657.

applying property principles to oil and gas transactions should not be a hit or miss proposition designed to avoid careful drafting and thoughtful actions. The Rule does not create insurmountable impediments to oil and gas transactions. Where it is applicable because the nature of the transaction is one based on property principles, it should be applied. Where it is not applicable either because the property interest created in not a contingent future interest or because no property interest is involved it should be ignored. Courts have largely shown the ability to discern where the Rule should be applied and where it should be ignored. The common law has shown the resiliency to change to meet changing societal needs over the past 1000 years. The Rule itself has changed in the past 300 years and continues to evolve to meet current societal objectives. It should not be thrown out based on the grounds of expediency. It should continue to control those types of transactions which have the effect of "fettering" property interests in a socially undesirable way.

137. For example, attempts to apply the Rule to the situation where an easement is granted that allows the dominant tenement to lay additional pipeline in the future is universally found not to involve the Rule. See, e.g., Kleinheider v. Phillips Pipe Line Co., 528 P.2d 837 (8th Cir. 1975); Caruthers v. Peoples Natural Gas Co., 155 Pa. Super. 332, 38 A.2d 713 (1944); Williams v. Humble Pipe Line Co., 417 S.W.2d 453 (Tex. Civ. App. 1967). See also Phillips Petroleum Co. v. Peterson, 218 F.2d 926 (10th Cir. 1954), cert. denied, 349 U.S. 947 (1955) (which rejects the application of the Rule to the pooling power created in an oil and gas lease).