Title: AN INTRODUCTION TO KANSAS LAW IMPACTING THE OIL & GAS INDUSTRY

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AN INTRODUCTION TO KANSAS LAW IMPACTING THE OIL & GAS INDUSTRY
Property Law, Contract Law, Oil & Gas Law

Prepared for:

SHELL OIL COMPANY

Presented:

June 13, 2012
Anthony, Kansas

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I. INTRODUCTION

A. "Oil & Gas" Law

1. Kansas, like other states, has a body of law that the industry, the public, and the courts, refer to as "oil and gas" law.

2. Depending upon the issue, "oil and gas" law is either a simple *application* of property law and contract law to the oil and gas subject matter, or it is an *adaptation* of property law or contract law to create a unique rule that we label "oil and gas" law.

   a. "Adaptation" will in many cases be, at most, a charitable way of describing what courts do to property law and contract law to develop a new rule of "oil and gas" law.

   b. The courts may also "adapt" other bodies of law for application to the oil and gas context, such as corporate law (*e.g.*, affiliate transactions).

3. As we proceed through these materials, I will try and identify when the Kansas courts have moved from application to adaptation, the result, and why

they were inclined to "adapt" instead of "apply."

4. For a critical analysis of this adaptation process, see: David E. Pierce, *The Renaissance of **Law** in the **Law** of Oil and Gas: The Contract Dimension*, 43 WASHBURN L. J. 909 (2004).

B. Property Law

1. We will by examining basic ownership principles for all types of property encountered in Kansas and how those principles apply in the oil and gas context.

2. We also examine the process of transferring property and the system that has been established to provide a record of property transfers.

C. Contract Law

1. Every transfer of property is preceded by some sort of contract.

2. The oil and gas lease, although governed by a number of property law principles, is also governed by contract law.

D. Regulatory Law

1. State statutes impact all aspects of the oil and gas business.

2. State statutes have a direct impact on property law and contract law.

3. Regarding "oil and gas" activities, state statutes have delegated authority to the Kansas Corporation Commission which has, in turn, adopted regulatory law to address many aspects of the oil and gas development process.

E. The Kansas Oil & Gas Handbook

1. In 1986 I addressed the issues I am discussing during this presentation in a book published by the Kansas Bar Association titled: KANSAS OIL & GAS HANDBOOK. It was last updated in 1991 and is currently out of print.

2. I own the copyright and all rights to the work. I am allowing Shell Oil Company to have access to, and reproduce, the book for use by Shell Oil Company personnel (employees and contractors), but not for general distribution or sale. To access a pdf of the book, which you can download and print from, go to the Washburn Law School website at:

http://washburnlaw.edu/kansasoilandgas/
Enter the user name: davidpierce
Enter the password: 19861991!

II. BASIC PROPERTY LAW ISSUES

A. Rules of Land (and Oil & Gas) Ownership

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

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

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

4. ***Kansas Natural Gas Co. v. Bd. of Commr's of Neosho County***, 89 P. 750 (Kan. 1907):

   "Until discovered and brought to the surface, no severance of title occurs. The minerals not only remain a constituent part of the land, but ***they belong to the owner of the surface soil beneath which they lie.***" *Id.* at 751 (emphasis added).

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

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

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

B. The Oil & Gas "Stick"

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

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

unreasonable restraints on alienation.

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

"(b) No person other than the surface owner of a tract of land shall have the right to use such land for the production of wind or solar generated energy ***unless granted such right by the lawful owner of the surface estate*** by lease or easement for a definite period. . . .

(d) Nothing in this section shall be construed to affect any otherwise enforceable ***restriction on the use of any tract of land for the production of wind or solar energy*** whether or not such restriction is in the form of an easement for a definite term."

4. It is possible to create a property interest in the oil and gas that is separate from the balance of rights in the property. For example, the court in ***Shaffer v. Kansas Farmers Union Royalty Co.***, 69 P.2d 4 (Kan. 1937) observed:

"***It is well settled in this state that petroleum and natural gas are minerals*** and, as long as they remain in the ground, are a part of the realty ***and belong to the owner of the land.***. . . . That is true notwithstanding the fact they are fugitive fluids. . . . When land contains minerals, there may be separate ownership of the minerals in one person and the remainder of the land in another. This separate ownership may be accomplished by the owner of the entire estate in the land conveying all of it except the minerals, or by conveying the minerals only. . . . An owner of land may convey all of it, or part of it. When he conveys but a part of it, ***he may divide it vertically or horizontally, and he may convey full title, or a fractional interest in the whole or in any part.***" *Id.* at 7.

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

   b. Must be explicit about the substances being conveyed.

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

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

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

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

7. Are oil and gas encompassed by a grant of "minerals"?

a. ***Roth v. Huser***, 76 P.2d 871 (Kan. 1938) (yes, in this case).

b. 1904 deed of land by Clarke (Huser) to Roth which contained the following language:

"reserving the mineral deposits thereon and therein, if any."

c. Issue: are oil and gas encompassed by the term "mineral deposits"?

d. Answer: affirm the trial court's conclusion of law that "[t]he term 'mineral deposits' as used in said deed included oil and gas." *Id.* at 874.

e. A few preliminary issues to consider in the ***Roth*** case:

(1) The trial court admitted extrinsic evidence that Clarke's agent, when the conveyance was made, orally indicated it was limited to gold and coal. Although the trial court indicated it was not relying upon the evidence, it also found that Clarke's transferee for value was protected by the recording act from such extrinsic evidence not contained within the deed: "[Clarke's grantee of the excepted mineral rights] is an innocent holder for value of the mineral rights in question and had a right to rely upon the record as it appeared in the office of the register of deeds of Ellis county, Kansas, when he took the conveyance of these mineral rights . . . ." *Id.*

(2) Some of the extrinsic evidence admitted would seem to be proper to consider, even though the deed was not deemed "ambiguous."

(a) This was the evidence concerning the surrounding circumstances at the time the conveyance at issue was made.

(b) As a matter of presumed "general" intent, what would

a grantor and grantee, at the time of conveyance, have known about oil and gas?

(c) Findings by the court: no producing wells within 225 miles of Hays, Kansas (where the land was located); existence of commercial oil and gas supplies in Ellis County unknown; exploration for oil within 20 miles of the land; oil well being drilled in Ellis County during the months prior to the conveyance and "***[s]everal mentions of it were made in the newspaper*** published in the city of Hays during September and October, 1903, and that two test wells were drilling in Rush county in 1903, but no oil or gas has been taken from the land in question ans no drilling for either has taken place thereon . . . ." *Id.* at 873.

(d) With regard to the use of "surrounding circumstances" evidence to interpret oil and gas documents, see: David E. Pierce, *"Surrounding Circumstances" Evidence in Natural Resources Litigation and the Effective Use of* ***Daubert*** *to Manage Expert Testimony*, 51 ROCKY MTN. MIN. L. INST. 13-1 (2005).

(e) With regard to the use of industry custom and usage as a special type of surrounding circumstances evidence to interpret oil and gas documents, see: David E. Pierce, *Defining the Role of Industry Custom and Usage in Oil & Gas Litigation*, 57 SMU LAW REV. 287 (2004).

(3) "Technically speaking, the interest in the land retained by the grantor in this deed to the plaintiff was ***an exception, rather than a reservation***, but the two terms are often used interchangeably and the technical meaning will give way to the manifest intent." 76 P.2d at 875.

f. Grant of rights "for the sole purpose of mining and removing Volcanic Ash, ***and all other minerals or mineral derivatives***" does not include oil or gas. ***Davis v. Plunkett***, 353 P.2d 514, 515 (Kan. 1960). Noting the "object" of the lease was to mine volcanic ash and gypsum, "the specific reference to volcanic ash and gypsum, and to

a right of way to the 'deposit,' limits the lease to those minerals." *Id.* at 516.

8. Interpretive tests:

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

      (1) Note this statute would require that the same language, *e.g.*, "mineral deposits," be interpreted either broadly, or narrowly, depending upon whether it is contained in a grant (broadly in favor of grantee) or an exception (narrowly against grantor).

      (2) More than a rule of construction.

      (3) What about interpretation of a grant of "coal and the right to mine and remove sale"? Can the statute be used to require that the term "coal" be interpreted broadly (against the grantor) to include methane gas within the coal? Yes in Alabama, but not in Kansas. ***Central Natural Resources, Inc. v. Davis Operating Co.***, 201 P.3d 680, 689 (Kan. 2009) ("Given that the deeds expressly tell us that not all of the grantors' estates passed to the grantees, we need not resort to the statutory presumption.").

      (4) This is a very useful statute that places all doubt concerning the scope of a conveyance on the grantor and not the grantee. As we will discuss later, this may provide an answer to *Duhig* situations.

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

      (1) ***Keller v. Ely***, 391 P.2d 132 (Kan. 1964) ("Except all gas, oil and mineral rights . . . and the right to enter upon said premises for the sole and only purpose of mining and operating for oil and gas, laying pipelines, building tanks, power stations, and structures thereon to produce, save and take care of said products.").

(2) Supreme court quotes the trial court's observation: "'We have all seen land tracts with sand and gravel pits that became worthless appearing as the exhausted coal-mining areas in Southeast Kansas. Did the grantee particularly intend that the grantor was reserving sand and gravel under the term 'minerals?'" *Id.* at 134.

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

(1) This is why, in the *Roth* case, the grantor that excepted the "mineral deposits" offered into evidence the Hays newspaper articles discussing drilling activity in the general area.

(2) The goal was to show that the parties could have contemplated oil and gas at the time the mineral exception was created.

(3) Positive *and negative* connotations from community knowledge: "nobody knew it existed, therefore it could not be contemplated" versus "everybody knew it existed, so if the parties intended it to be included they would have said so."

d. **Common/special varieties test.** Is the sand, limestone, etc. "special" or "ordinary"? Special sand is a "mineral" while ordinary sand is not. No Kansas cases addressing the common varieties test.

e. ***Ejusdem generis* interpretive guide.** Conveyance of "oil, gas, ***and other minerals***" limits the scope of "other minerals" to minerals that are similar to oil and gas.

(1) Of all the interpretive rules, Kansas has most clearly adopted *ejusdem generis*. ***Keller v. Ely***, 391 P.2d 132 (Kan. 1964) ("Except all gas, oil ***and mineral rights*** . . . and the right to enter upon said premises for the sole and only purpose of mining and operating ***for oil and gas***, laying pipelines, building tanks, power stations, and structures thereon to produce, save and take care of said products.").

(a) "[T]he general terms contained in the reservation must be deemed to embrace and include only those things similar in nature to those previously specifically enumerated–that is, oil, gas and kindred minerals." *Id.*

at 136.

(b) Trial court also observed that the easement language suggests the parties were only focusing on oil and gas in the mineral granting language.

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

(3) Does not address what is encompassed by the term "gas." For example, would it include a nearly pure deposit on carbon dioxide.

f. Basic problem with the case law: court recites a number of tests and then declares a conclusion–without addressing which tests should be applied first, or how conflicting outcomes under a test should be resolved.

g. *See* 1 DAVID E. PIERCE, KANSAS OIL AND GAS HANDBOOK 6-4 to 6-9 (1986); David E. Pierce, *Toward a Functional Mineral Jurisprudence for Kansas*, 27 **Washburn L. J.** 223 (1988).

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

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

b. Will ownership of the shale rock include ownership of gas found within the shale rock? Probably not.

c. Beware of conveyances that sever subsurface depths but fail to address the oil and gas resource within the severed depths. For example: "***O*** conveys to ***A*** rights below the base of the Hugoton formation." What have they conveyed? The rock? The rock and the oil and gas within the rock?

C. Ownership In-Place of Oil & Gas

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

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

    a. Classified as real property.

    b. Cannot be abandoned; have real property remedies.

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

3. *See generally* 1 DAVID E. PIERCE, KANSAS OIL AND GAS HANDBOOK 4-13 to 4-17 (1986). Subsequent citations to the Handbook will be shortened to: **Handbook** (page number).

D. Classification of the Oil & Gas Lease

1. Kansas courts early on described the oil and gas lease as creating a "license." Subsequent cases describe the oil and gas lease as creating a profit à prendre. I will follow the RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES and refer to the profit à prendre as simply a "profit." I will abbreviate the *Restatement* as **Restatement of Servitudes**.

    a. Kansas courts have also classified an oil and gas lease as an interest in personal property.

    b. Profits and easements (and licenses) are not personal property. They are nonpossessory interests in land; real property interests. The **RESTATEMENT (FIRST) OF PROPERTY** § 450 (1944) stated it best: "An easement is ***an interest in land*** in the possession of another . . . ."

    c. But, in Kansas, when encompassed within an "oil and gas lease," the profit and associated easements are personal property.

2. Technically, the oil and gas lease cannot be a "license" because the major attribute of a license is that it can be revoked at will by the landowner granting the license.

3. **Restatement of Servitudes § 1.2(4)**: noting the common misuse of the term, provides: "As used in this Restatement, the term 'easement' includes an irrevocable license to enter and use land in the possession of another . . . ."

4. What is a "profit"? **Restatement of Servitudes § 1.2(2)**:

   "A profit à prendre ***is an easement*** that ***confers the right to enter and remove*** timber, ***minerals, oil, gas***, game, or other substances ***from land in the possession of another***. It is referred to as a 'profit' in this Restatement."

5. What is an "easement"? **Restatement of Servitudes § 1.2(1)**:

   "An easement creates ***a nonpossessory right to enter and use land in the possession of another*** and obligates the possessor not to interfere with the uses authorized by the easement."

6. As one property scholar notes:

   a. "[E]asements allow some use to be made of the burdened land, while profits allow some substance to be severed and removed."

   b. "[A] profit nearly always is accompanied by easement rights, implied, if not, as should be done, expressly spelled out in the grant. A profit to remove any substance must necessarily carry with it access over the burdened land sufficient to reach, work, and remove the substance."

   c. WILLIAM B. STOEBUCK & DALE A. WHITMAN, THE LAW OF PROPERTY 437 (3d ed. 2000).

7. There is one thing about oil and gas law that all courts in all states agree upon: **nowhere is an "oil and gas *lease*" a "lease."** It is either a conveyance of the oil and gas in place, typically for a defeasible term (as in Texas), or it is a defeasible term profit (as in Kansas). In either case the interest will be accompanied by express, and in some cases, implied, easements.

8. Technically, in Kansas the oil and gas lease would be more properly titled: "Profit and Associated Easements." But, that will never happen.

   Consider the granting clause of the Shell form of "Oil and Gas Lease" being used in Kansas.

¶ 1: "The Lessor, for and in consideration of the sum of Ten and More Dollars ($10.00) in hand paid and of the covenants and agreements hereinafter contained to be performed by the Lessee, has this day ***granted, leased, and let and by these presents does hereby grant, lease, and let exclusively unto the Lessee the hereinafter described land***, with any reversionary rights therein, and with the right to unitize this lease or any part thereof with other oil and gas leases as to all or any part of the lands covered thereby as hereinafter provided, ***for the purpose of carrying on geological, geophysical and other exploratory work thereon***, including core drilling and the drilling, mining, and operating for, producing and saving all of the oil, gas, gas, condensate, gas distillate, casinghead gasoline and their respective constituent vapors, and all other gases, found thereon, ***the exclusive right of injecting water, brine, and other fluids and substances into the subsurface strata, and for constructing roads, laying pipe lines, building tanks, storing oil, building power stations, electrical lines, power poles and other structures thereon*** necessary or convenient for the economical operation of said land alone or conjointly with neighboring lands, ***to produce, save, take care of, and manufacture all of such substances, and the injection of water, brine, and other substances into the subsurface strata***, said tract of land being situated in the County of _____, State of Kansas, and described as follows:

An Alternative Drafting Approach to Reflect Kansas Case Law and Statutory Law:

The Lessor, for and in consideration of the sum of Ten and More Dollars ($10.00) in hand paid and of the covenants and agreements hereinafter contained to be performed by the Lessee, =

Lessor, for valuable consideration,

has this day granted, leased, and let and by these presents does hereby grant, lease, and let exclusively unto the Lessee the hereinafter described land, with any reversionary rights therein, and with the right to unitize this lease or any part thereof with other oil and gas leases as to all or any part of the lands covered thereby as hereinafter provided =

conveys to Lessee, the exclusive right to enter the Land

[Note: The lease would include a separate after-acquired-title clause that will pick up reversionary rights, accretions, and any other interest the grantor may obtain in the land that they do possess at the time of the grant.]

for the purpose of carrying on geological, geophysical and other exploratory work thereon, including core drilling and the drilling, mining, and operating for, producing and saving all of the oil, gas, gas, condensate, gas distillate, casinghead gasoline and their respective constituent vapors, and all other gases, found thereon, the exclusive right of injecting water, brine, and other fluids and substances into the subsurface strata, and for constructing roads, laying pipe lines, building tanks, storing oil, building power stations, electrical lines, power poles and other structures thereon necessary or convenient for the economical operation of said land alone or conjointly with neighboring lands, to produce, save, take care of, and manufacture all of such substances, and the injection of water, brine, and other substances into the subsurface strata, said tract of land being situated in the County of _____, State of Kansas, and described as follows:

In addition to said land, Lessor hereby grants leases and lets exclusively unto Lessee to the same extent as if specifically described herein all lands owned by or claimed by Lessor which are adjacent, contiguous to or form a part of said land, including all oil, gas and all substances produced in association therewith underlying all alleys, streets, roads, highways, lakes, rivers, streams, or other bodies of water, easements and right of way which traverse or adjoin any of said land.

to remove oil and gas, including gas found in coal seams, shale formations, and other rock structures, and including all substances produced in conjunction with the oil and gas. In addition to these profit rights, Lessee is conveyed easements to access and use the Land in any manner that is necessary or convenient to explore, develop, produce, treat, store, process, and market oil and gas from the Land, or any lands being developed in conjunction with the Land. These easements include the right to apply any technology or technique, whether currently in existence or developed in the future, that the Lessee believes is appropriate to maximize the production of oil and gas from the Land.

E. Classification and the Nonparticipating Royalty Interest

1. Kansas has a tortured body of law regarding the nonparticipating royalty interest.

2. It is classified as an interest in personal property and is also deemed to be inherently a future interest – an executory interest – that cannot vest until, and unless, there is production. This has triggered the Rule Against Perpetuities and resulted in the voiding of many, otherwise valid, nonparticipating royalty interests.

3. Oddly enough, a nonparticipating *mineral* interest, that participates only in royalty as a mineral owner, is deemed to be a real property interest, that vests immediately, and therefore not subject to the Rule Against Perpetuities.

4. ***O*** conveys to ***A*** 1/16th of the oil and gas produced from §30. (Nonparticipating *royalty* interest, void under the Rule Against Perpetuities).

O conveys to ***A*** ½ of the oil and gas in and under §30, excepting to ***O*** the right to execute leases, conduct development, and receive: bonus, delay rental, and shut-in royalty. (Nonparticipating *mineral* interest, Rule Against Perpetuities does not apply, ***A*** will receive ½ of the royalties generated under the oil and gas lease ***O*** grants).

5. *See* **Handbook** at pp. 4-21 to 4-24.

F. Rule of Capture

1. *Ad coelum* doctrine applies to the extent of defining the physical location of the well – it must be within the surface boundaries.

2. Any oil or gas produced from a well properly located, and bottomed, within surface boundaries, belongs to the owner of the well–even though it has migrated from adjacent lands. *E.g.*, ***Carlock v. Krug***, 99 P.2d 858, 861 (Kan. 1940) ("It is well settled in Kansas that the owner of the land and those holding under him own all the oil produced from wells located on the land and that owners of adjoining tracts must protect themselves by development of their own land."),

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

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

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

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

   d. **K.A.R. § 82-3-110(b)**. "If the commission determines that good

cause has not been shown or that an exception should be denied, an order may be issued by the commission requiring the well to be permanently capped or plugged and abandoned . . . or production at a reduced rate may be permitted by the commission to ensure the protection of correlative rights and the prevention of waste."

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

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

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

   c. GAS: **K.A.R. § 82-3-312(a)**. "Standard daily allowable. The standard daily allowable for a gas well shall be limited to 50 percent of the well's actual open-flow potential. . . ."

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

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

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

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

acres."

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

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

G. Rights Within the Connected Reservoir

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

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

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

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

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

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

boundary lines.

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

3. The KCC defines correlative rights as:

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

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

4. The Kansas hydraulic fracturing and correlative rights case: ***Zinke & Trumbo, Ltd. v. State Corp. Comm'n***, 749 P.2d 21 (Kan. 1988) (court reversed proration formula where KCC failed to consider that the well had been fractured, and the evidence showed the fractures extended over 400 feet from the wellbore that was 330 feet from the objecting party's lease line.

a. "Under the KCC's duty to protect correlative rights to natural gas in a common source of supply, we find evidence of fracture treatment to a well or wells in the common field to be one of the 'other factors, conditions and circumstances' which must be considered in making a proration order. It is particularly important where a well's open flow is 50% of its allowable production. The BPO [basic proration order] does not reveal, nor do we find, that the fracture treatment to Sho-Bar's Fincham 1-30 well was considered by the KCC in making its BPO. We hold the order is thus unreasonable." *Id.* at 28.

b. A correlative rights analysis should take care of these problems. If it is an acceptable way to efficiently develop the reservoir, then it should be allowed, and encouraged.

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

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

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

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

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

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

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

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

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

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

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

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

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

III. COMMON FORMS OF PROPERTY OWNERSHIP

A. Tenancy in Common

1. When more than one person owns property, they typically hold title as tenants in common.

2. ***O*** conveys § 30 to ***A*** and ***B***.

   a. Following this conveyance ***A*** and ***B*** each own an undivided one-half of § 30 as tenants in common.

   b. The presumption, absent a different allocation in the deed, is that ***A*** and ***B*** will own § 30 in equal shares.

3. The basic rule applies to lifetime conveyances and conveyances by will.

4. **K.S.A. § 58-501**. "Real or personal property ***granted or devised*** to two or more persons ***including a grant or devise to a husband and wife*** shall create in them a tenancy in common with respect to such property unless the language used in such grant or devise makes it clear that a joint tenancy was intended to be created . . . ."

   a. However, the presumption is to create a joint tenancy when the grant or devise is to "executors or trustees."

   b. Kansas abolished the tenancy by the entirety by statute in 1891. ***Hall v. Hamilton***, 667 P.2d 350, 354 (Kan. 1983).

5. Frequently, cotenancy relationships are created by intestate succession laws. Whenever two or more people are entitled to inherit from a decedent, they take the undivided interest specified by the intestacy statutes as tenants in common. *E.g.*, **K.S.A. § 59-505** (surviving spouse takes one-half the property); **K.S.A. § 59-506** (surviving children share the other one-half equally).

B. Joint Tenancy

1. The next most common form of property ownership is joint tenancy with the right of survivorship.

2. Two major issues:

a. What language must be used to overcome the statutory presumption of a tenancy in common? (Lots of attention to this issue).

b. Has anything taken place during the joint tenancy to cause it to become "severed" and thereby automatically converted to a tenancy in common. (Almost no attention to this issue).

c. Why this is so important: title takes a "right turn" that is not anticipated, particularly where the grantees are not related.

(1) When ***O*** conveys § 30 to ***A*** and ***B***, problems arise when it is not clear whether a joint tenancy was created, or even if it was clear a joint tenancy was created, it can always be unilaterally converted to a tenancy in common by either party – or even third parties.

(2) If ***A*** dies first, ***A***'s interest either goes to ***B*** (as the surviving joint tenant) or to ***A***'s devisees under a will, or to ***A***'s heirs by intestate succession (if a joint tenancy was not created, or if it was created, but was severed prior ro ***A***'s death).

3. **Creating a Joint Tenancy.** There must be no ambiguity of the grantor's intent to create a joint tenancy as opposed to a tenancy in common.

a. ***Riggs v. Snell***, 350 P.2d 54 (Kan. 1960). Grant to husband and wife "or the survivor of either" did not create a joint tenancy where body of deed made references to the parties' "heirs, executors and administrators or assigns." If a joint tenancy were intended, then the property would not go to the grantee's "heirs" but instead to "survivors."

b. In *Riggs* the son was suing his father to get his intestate share of the property when his mother died.

c. *Riggs* is also important because it uses the KANSAS TITLE STANDARDS as persuasive authority to analyze the issues.

"[T]hese 'title standards' ***are not binding on this court–but they are entitled to consideration as being the consensus and general understanding of the bar of the state on the subject.*** We quote material portions of them: . . . ." *Id.* at 57.

4. **Destroying a Joint Tenancy (The Joint Tenancy Audit).**

a. What is a joint tenancy audit? It is a study of events taking place under the joint tenancy relationship to determine whether it has, in fact, been severed so that the presumed deceased joint tenant is actually a cotenant that retains their undivided interest in their estate at death.

b. The risks here can be significant because if the joint tenancy was severed during the decedent's lifetime, the decedent's undivided interest will not go to the surviving joint tenant but will instead pass under the decedent's will or intestate succession – or by other means, such as a transfer-on-death deed.

c. It is a high-risk proposition because it is generally "winner-take-all," meaning if there has been a "severance" of the joint tenancy the surviving joint tenants will take nothing from the decedent; the decedent's heirs or devisees will take "all" the decedent's interest.

d. When joint tenants entere into different oil and gas leases at different times (even though with the same lessee), did that act sever the joint tenancy and create a tenancy in common by operation of law?

(1) Issue has not been litigated in Kansas – probably because the prospect of a severance was not considered by anyone.

(2) The issue was recently the subject of litigation in Pennsylvania. ***In re Estate of Quick***, 905 A.2d 471 (Pa. 2006) (no severance of the joint tenancy resulted because there was no "intent" to sever).

e. If one joint tenant enters into a mortgage will that cause a severance of their interest in Kansas?

(1) Because Kansas follows a "lien" theory of mortgages, as opposed to a "title" theory, it should not result in a severance because nothing has been conveyed to the mortgagee.

(2) However, we have problems with "***dicta* law**" on this subject in ***Hall v. Hamilton***, 667 P.2d 350, 354-55 (Kan. 1983), where the court stated:

"It is undisputed that any joint tenant may sever his or her

joint tenancy interest in real property by . . . ***mortgaging the joint tenancy interest*** . . . .")

(3) Although the statement in ***Hall*** was *dicta*, it was picked up as "law" in ***Hutchinson National Bank and Trust Co. v. Brown***, 753 P.2d 1299, 1301 (Kan. Ct. App. 1988), *rev. denied* (June 22, 1988), where the court states:

"The Bank contends that the plain language in *Hall* requires Kansas courts to find that a pledge acts as a severance of the joint tenancy interest because there is no legal distinction in the operative effect of a mortgage or pledge (other than the type of property encumbered). We agree."

(4) What does the governing statute say regarding the mortgage/pledge issue?

(a) The governing statute is **K.S.A. § 58-501**, which has been around since 1939, and is one of the few provisions of the 1939 Property Act that was given complete retroactive effect: "The provisions of this act shall apply to all estates in joint tenancy in either real or personal property ***heretofore or hereafter created*** . . . ."

(b) The last phrase of K.S.A. § 58-502 makes it clear that the mere granting of a lien on property is not viewed as the severing event, but rather the foreclosure of the lien that results in a change of title through an actual ***sale*** of the interest:

"[N]othing herein contained shall prevent execution, levy and sale of the interest of a judgment debtor in such estate and ***such sale shall constitute a severance***."

(c) No court in Kansas has focused on this express language in the statute – at least not in the *Hall* or *Hutchinson National Bank* contexts.

(5) The mortgage issue, and even the pledge issue, remain open issues in Kansas.

(a) K.S.A. § 58-502 takes the most appropriate approach to the issue by making an actual change of title to the encumbered interest the clear, defining event in which a severance will occur.

(b) Until a sale, and the resulting change in ownership, the joint tenancy would remain in effect. Not even the filing of a foreclosure action would cause a severance because no change in title will occur until the action has successfully run its course and a sale is completed.

(c) If a lender wants to protect itself from the winner-take-all aspects of joint tenancy, it should, as a condition to making the loan, require their borrower to sever the joint tenancy and convert it into a tenancy in common – unless, of course, the bank feels lucky and the borrower is the youngest and healthiest of the joint tenants.

5. **Technical aspects of severance: "destroying" one of the "four unities."** The "four unities" at common law required to create, and maintain, a joint tenancy are:

Interest: the tenants must have one and the same interest.

Title: the interests must accrue by one and the same instrument or conveyance.

Time: the interests must commence at one and the same time.

Possession: the property must be held by one and the same undivided possession.

a. If one of the "unities" is "destroyed," or "lacking," then the joint tenancy becomes a tenancy in common and the survivorship rights are eliminated.

b. Is it possible for a joint tenant to own less than an equal, undivided interest and still satisfy the unity of "interest" (tenants must have one ***and the same*** interest)? Not really – except, perhaps, in Kansas.

c. ***In re Estate of Lasater***, 54 P.3d 511 (Kan. Ct. App. 2002), *rev. denied* (Dec. 17, 2002) (joint tenancy can be created when one joint

tenant is conveyed 99% and the other 1% – this does not, according to the court, violate the unity of interest). ***Lasater***: right result, even though the unities analysis is open to challenge.

d. A strong argument can be made that ***courts need to abandon the unities analysis altogether.***

(1) The unities analysis never fit the cases dealing with bank accounts.

(2) The Court of Appeals in ***Lasater*** properly focuses on the ***intent*** of the parties to resolve these issues. The intent was extremely clear in ***Lasater***.

e. **K.S.A. § 58-501** provides a statutory basis for abandoning the unities analysis and focusing on intent by providing:

"Real or personal property granted or devised to two or more persons including a grant or devise to a husband and wife shall create in them a tenancy in common with respect to such property ***unless the language used in such grant or devise makes it clear that a joint tenancy was intended to be created*** . . . ."

6. ***In re Kasparek*, 426 B.R. 332 (B.A.P. 10th Cir. 2010).**

a. The trustee in bankruptcy commenced a Bankruptcy Code 11 U.S.C. § 363(h) proceeding to sell all rights in the land in which Jonathon held legal title to a 1/3rd undivided interest as a joint tenant with his brother James and his father Wayne.

b. When the requirements of § 363(h) are met the trustee can sell 100% of the jointly held property in order to maximize the value of the debtor's undivided interest in the property.

c. The non-debtor joint owners are forced to sell their interests; if they want to keep the land, they have to be the successful bidders at the sale.

d. Separate from the right to sell Jonathon's 1/3rd interest, a preliminary issue is whether Jonathon really owns a 1/3rd interest when it can be proven: the father paid all the purchase price, manages the property as his own, and intended the joint tenancy merely as an estate planning tool – with no intent to make a present gift of the interest to

either of the two sons.

e. ***In the past, Kansas courts have been willing to look behind the recorded document to ascertain the true intent of the parties to the conveyance – even though there is nothing ambiguous about the deed.*** Opportunity for courts to practice some equity to protect the party contributing the money – typically from a child's creditor.

f. Part of this willingness may be the product of applying bank account and other personal property joint tenancy law to the real property context.

g. This is understandable since K.S.A. § 58-501 applies to "***[r]eal or personal*** property granted or devised to two or more persons . . . ."

h. However, the world of personal property does not operate under the real property recording laws, such as K.S.A. § 58-2221 (providing for recording of "[e]very instrument in writing that conveys . . . [r]eal estate . . . or . . . whereby any real estate may be affected . . . .") and K.S.A. § 58-2222 (recording imparts "notice to all persons of the contents thereof; and all subsequent purchasers and mortgagees shall be deemed to purchase with notice.").

i. But, personal property often operates under its own unique bodies of law, such as the Uniform Commercial Code. *E.g.,* ***Bridges v. Central Bank and Trust Co.***, 926 F.2d 971 (10th Cir. 1991) (certificate of deposit owned by five individuals in "or" form, and held in joint tenancy, could be pledged by any one of the five and allow the creditor to receive 100% of the proceeds upon default; relying upon UCC § 3-116(a) and § 9-1205).

7. The court in ***Kasparek*** explores the precise basis for allowing a court to look behind the recorded document and holds that in Kansas the theory is based upon an implied trust which implicates statutes that specifically address the concept in real estate transactions.

a. **K.S.A. §§ 58-2401 to 58-2408** is an act, that took effect in 1868, to address the use of trusts in land to defraud creditors.

b. Under the facts, the father Wayne had the burden to establish that his son Jonathon had an agreement to hold the property in trust for the father.

c. The court proceeds under the assumption Wayne was able to show an agreement that Jonathon held his interest in trust for his father – but then addresses the effect this unrecorded interest would have on a bona fide purchaser.

d. The court concludes: ***"The rights and powers of a bona fide purchaser include the right to obtain title to property free of certain unrecorded interests..."*** and, for purposes of the trustees avoidance powers under 11 U.S.C. § 544, it is not necessary to have a transfer by the debtor to trigger the trustee's bona fide purchaser status.

e. **The court's opinion does an excellent job of collecting and analyzing Kansas cases on a BFP's obligation to make inquiry of facts beyond the recorded document.**

(1) Issue: to what extent must the trustee (BFP) make inquiry regarding the nature of the holdings by the three named joint tenants?

(2) Held: the joint tenancy deed establishes, as a matter of law, that the parties each owned an undivided one-third interest in the property and, absent special circumstances triggering a duty to inquire beyond the deed, no duty exists – merely because the property is held in joint tenancy.

(3) The court reasons:

"We believe that a duty to inquire about the possibility of an implied trust or other unrecorded agreements when title is held by joint tenants undermines the purpose of the Kansas recording statutes, imposes an undue burden on purchasers, and impairs the reliability of record title."

C. Transfer-On-Death Deeds

1. The court in ***Kasparek*** offered the following thoughts:

"We also note that, by statute, Kansas permits interests in real property to be titled in a 'transfer-on-death' form, so that the estate planning attempted by Wayne could have been accomplished by designating directly on the deed the beneficiaries in whom the Property would vest upon his death. *See* Kan. Stat. Ann. § 59-3501. Such a designation may be changed or revoked without the consent of the beneficiary. *Id.* § 59-3503. The

availability of transfer-on-death deeds in Kansas obviates the need to resort to a joint tenancy deed as an estate planning tool, and increases the reliability of land records. ***The fact that Kansas has such a statute further weighs against imposing a duty on purchasers to inquire of joint tenants regarding whether their interests are subject to a secret trust and were intended to vest only on death of one of the joint tenants.***"

2. Kansas Statutes Annotated, Chapter 59, Article 35. – Transfer-On-Death

   a. **K.S.A. §§ 59-3501 to 59-3507** (real estate).

   b. **K.S.A. §§ 59-3508 to 59-3512** (motor vehicles).

   c. **K.S.A. § 59-3512** (other nontestamentary transfers).

3. Addresses all the testamentary issues regarding an incomplete, totally revocable, gift. **K.S.A. § 59-3507** ("A deed in transfer-on-death form shall not be considered a testamentary disposition and shall not be invalidated due to nonconformity with the provisions of chapter 59 of the Kansas Statutes Annotated.").

4. The only formality required: the deed must be recorded. **K.S.A. § 59-3501(a)**.

   a. No delivery requirement.

   b. Grantee/beneficiary need not be aware that the conveyance exists. **K.S.A. § 59-3501(b)**.

5. The only unique limitation: cannot be "revoked by the provisions of a will." **K.S.A. § 59-5503(c)**.

6. If no alternative beneficiaries stated in the deed, the gift will lapse if the designated beneficiary predeceases the grantor. **K.S.A. § 59-3504(c)**.

7. Transfer-on-death conveyance by a joint tenant will ***not*** sever the joint tenancy; the transfer-on-death beneficiary will receive the interest only if the joint tenant grantor is the last surviving joint tenant. **K.S.A. § 59-3505**.

8. What follows is a 2006 drafting exercise, concerning Transfer-On-Death Deeds, given to my students at Washburn.

TRANSACTIONAL SKILLS
DRAFTING

Applying Legal Principles to Accomplish the Client's Goals

Today among the most important estate planning tools are the durable power of attorney and transfer-on-death documents. Transfer-on-death documents are an improvement over the use of joint tenancy as a probate-avoidance tool because the donee does not currently receive an enforceable right in the property. This means the donee has no power over the property and the donor can change the deed at any time without the donee's consent. If the donor fails to act, the property will pass to the currently listed donee at the donor's death. Absent statutory authorization, these transfer-on-death arrangements would violate the Statute of Wills. (The Kansas version of the Statute of Wills is found at Kan. Stat. Ann. § 59-606 (2005)). Because the donor if free to change their mind, the gift is not complete until the donor dies. Until the donor's death, they can alter the donee's ability to receive the property.

This Exercise addresses the drafting of a transfer-on-death ("TOD") conveyance. TOD conveyances are governed by Kan. Stat. Ann. §§ 59-3501 to 3507 (2005). However, you have a preliminary problem because the property being transferred is the right to receive a share of helium gas produced from wells drilled on land owned by Dock Hillard. In 1988 Dock received the interest described in the document labeled **Exhibit A**. Dock wants to use a TOD conveyance to transfer 76% of Dock's helium rights to his son, Stephen Hillard.

Step One of the Drafting Process: Validation.

First Task: Prepare a one-page memorandum of law addressing whether the helium royalty Dock wants to transfer to Stephen is an "interest in real estate" as contemplated by Kan. Stat. Ann. § 59-3501(a) (2005). You can assume that unless the interest is a § 59-3501(a) "interest in real estate," then the TOD procedures for "real estate" will not be available.

Second Task: As part of your validation process, consider the TOD provisions and the general statutes dealing with conveyances (Kan. Stat. Ann. §§ 58-2201 to 2223 (2005)). Also familiarize yourself with Kan. Stat. Ann. §§ 53-501 to 53-511 (2005). You will be using these statutes to guide your drafting of the required TOD conveyance.

Third Task: Draft the TOD conveyance to transfer 76% of Dock's helium royalty rights to Stephen.

Fourth Task: Draft a one page letter to Dock explaining what he needs to know about the TOD conveyance you have prepared. Dock has already asked you the following questions: (1) Do I have to give the TOD conveyance to Stephen? (2) Do I have to tell Stephen I have conveyed the interest to him? (3) After I sign and record the TOD conveyance to Stephen, can I later change my

mind and transfer the interest to someone else? (4) Can I use the value of the 76% interest covered by the TOD conveyance as collateral for a loan? (5) Can Stephen encumber the 76% interest by borrowing against it? Provide Dock with the information he will need to know in order to understand the rights created by his TOD conveyance to Stephen.

EXHIBIT A

STATE OF KANSAS)
) ss:
COUNTY OF SHAWNEE)

Witnesseth that on this 10th day of June 1988 Forrest Hillard, as the owner of the following land in fee simple absolute: Section 3, Township 11 South, Range 15 East of the 6th Principal Meridian, in Shawnee County, Kansas (the "Land"); hereby conveys and warrants to Dock Hillard, for a term of 21 years from the date of this conveyance, and so long thereafter as helium is produced from the Land, one-eighth of all the helium produced and saved from the Land.

FORREST HILLARD

Prepare the documents and deliver your final product to Shirley in Room 302 **by Noon on March 10, 2006**. Obtain your examination number for this Exercise #8 from Shirley.

As appropriate, apply the principles set out in Richard Wydick's *Plain English for Lawyers* and the citation format specified in the "Practitioners' Notes" portion of *The Bluebook.* All citations should be imbedded in the text of your work; no footnotes. Edit your work.

MEMORANDUM OF LAW

TO: File
FROM: David E. Pierce
SUBJECT: Scope of phrase "an interest in real estate" under Kan. Stat. Ann. § 59-3501 (2005).
DATE: 2 October 2006

I. QUESTION: Can the transfer-on-death ("TOD") device under Kan. Stat. Ann. § 59-3501 (2005) be used to transfer the right to a share of helium produced from land?

II. ANSWER: Most likely. An interest classified as personal property for "oil and gas law" purposes can still be "an interest in real estate" for purposes of the TOD statutes.

III. DISCUSSION: The meaning of the phrase "an interest in real estate," as used in Kan. Stat. Ann. § 59-3501(a) (2005), is a matter of statutory interpretation requiring application of Kan. Stat. Ann. § 77-201 (Supp. 2005), which provides: "In the construction of the statutes of this state the following rules shall be observed . . . Eighth. 'Land,' 'real estate' and 'real property' include lands, tenements and hereditaments, and all rights to them and interest in them, equitable as well as legal." This adopts a broad interpretation of "real estate" without any limitation on how the rights at issue might be classified for "oil and gas law" purposes. The critical inquiry is to ascertain the "intent of the legislature" when it used the phrase "an interest in real estate" to define the permissible scope of the TOD device. Mitchell v. Liberty Mut. Ins. Co., 24 P.3d 711, 719 (Kan. 2001).

In Dubowy v. Baier, 856 F. Supp. 1491 (D. Kan. 1994), the court applies a similar analysis to define the phrase "interest in . . . real property" as used in Kan. Stat. Ann. § 60-1002 (2005) (quiet title statute). The court surveys various sources defining the phrase "interest in real estate" and notes: "Among property rights that have been found by courts to constitute an interest in real estate are leases, easements, rights to royalties, right to profits and ownership of mineral rights." Id. at 1497 (emphasis added). This encompasses Dock's helium rights which are one of the metaphorical "sticks" comprising the bundle of sticks that make up the "real estate." Creation of the right requires a conveyance evidenced by a writing and administered under the recording acts. It is not similar to a transfer of a car or other item of tangible personal property that might be located on the land, instead it is a right, an interest, carved from land itself, "an interest in real estate."

The TOD statutes have not been addressed by Kansas courts. [***As of 2006***] Although for oil and gas law purposes Dock's helium interest could be classified as personal property, under certain circumstances it may also be classified as real property. See In re Sellens, 637 P.2d 483, 486 (Kan. Ct. App. 1981) (distinguishing "accrued" royalty from "unaccrued" royalty). Perhaps because of these inconsistent approaches, the court in National Bank of Tulsa v. Warren, 279 P.2d 262, 285-86 (1955), refused to apply oil and gas law classifications when evaluating whether conveyance of a production payment "affected" real estate under a mortgage registration tax statute. In Platt v. Woodland, 246 P. 1017, 1020 (Kan. 1926), the court, interpreting the scope of the term "estate" in a statute, holds the term was used as a "general" term, not a "technical" term and encompassed "whatever the grantor could convey . . . ." The phrase "interest in real estate," if similarly interpreted as a "general" term, would include Dock's helium interest that was carved out of the real estate.

TRANSFER-ON-DEATH DEED

Dock Hillard as owner ("Dock") transfers on death to his son, Stephen Hillard, as grantee beneficiary, the following described interest in real estate:

> An undivided 9.50% of 100% of all the helium produced from: Section 3, Township 11 South, Range 15 East of the 6th Principal Meridian, in Shawnee County, Kansas (the "Land"), for a duration continuing until 10 June 2009 and so long thereafter as helium is produced from the Land.

THIS TRANSFER ON DEATH DEED IS REVOCABLE. IT DOES NOT TRANSFER ANY OWNERSHIP UNTIL THE DEATH OF DOCK. IT REVOKES ALL PRIOR BENEFICIARY DESIGNATIONS BY DOCK FOR THIS INTEREST IN REAL ESTATE.

Signed 6 October 2006.

_____

DOCK HILLARD, Owner

ACKNOWLEDGMENT CERTIFICATE

Shawnee County, Kansas

This Transfer-On-Death Deed was acknowledged before me on 6 October 2006 by Dock Hillard.

_____

DONNA K. HAVERKAMP
Notary Public
My Appointment Expires:_____

Until notified otherwise, all tax statements that relate to the interest described in this Transfer-On-Death Deed should be sent to:

Dock Hillard, 1301 S.W. High, Topeka, Kansas 66604-1220.

David E. Pierce
Attorney-At-Law
4133 N.W. Brickyard Road
Topeka, Kansas 66618-3530
(785) 670-1676

Dock Hillard
1301 S.W. High
Topeka, Kansas 66604-1220

6 October 2006

Re: ***Transfer-On-Death Deed of Helium Interest to Stephen Hillard as Grantee Beneficiary***

Dear Dock:

Enclosed is the Transfer-On-Death Deed ("TOD" deed) you requested. Rights under a TOD deed are defined by several Kansas statutes. The TOD deed statutes apply to "an interest in real estate." This phrase is not defined and raises the issue whether a share of helium produced from land is "an interest in real estate." Complex classification principles create some risk the helium transfer could be challenged as not being an interest in real estate. My opinion is the statute will most likely be interpreted to include your helium interest. In the event I am wrong, it would mean the TOD deed to Stephen will not be given effect and the property will remain part of your estate.

There are several things you should know about the Transfer-On-Death Deed rules in Kansas. First, ***the transfer will not have any effect at your death unless the deed is recorded with the Register of Deeds prior to your death***. You do not have to give the deed to Stephen, or even inform him that you have made the deed, although recording will make it a matter of public record. You can change your mind at any time during your life by conveying the property to someone else, or by following a simple statutory revocation procedure. However, you can ***not*** revoke the TOD deed by your Will. Although you do not hold the helium in joint tenancy, in the event you did, entering into this TOD deed would not sever or otherwise change your rights as a joint tenant. You will be able to deal with the interest covered by this TOD deed in any manner you desire during your lifetime. You can borrow against it and use it as collateral; it will be subject to the claims of your creditors and Stephen will take the property subject to any conveyances, liens, and other burdens occurring during your lifetime. If Stephen dies before you, his interest will lapse, which means the property will be part of your estate at your death. Although it is possible to designate alternative beneficiaries in the TOD deed, you have not chosen to do that in your deed. Stephen will not be able to borrow against, or otherwise encumber the property.

As a relatively new approach to disposing of property, it is important that if you ever decide to revoke the transfer, or make other dispositions of this property, please contact me so I can assist you by ensuring all statutory requirements are met. Let me know if you have any questions.

Sincerely;

David E. Pierce

DEP:dep
Enclosure: Transfer-On-Death Deed

D. Life Tenancy

1. ***O*** conveys § 30 to ***A*** for life, remainder to ***B***.

   O conveys § 30 to ***A*** for life.

   a. In each case ***A*** has a present interest, limited to ***A***'s life.

   b. In the first conveyance, ***B*** has a future interest that is presently vested (an indefeasibly vested remainder in fee simple absolute), but ***B***'s ***possession*** of the land will not occur until ***A*** dies.

   c. In the second conveyance, ***O*** has a future interest that is presently vested (a reversion in fee simple absolute), but ***O***'s possession of the land will not occur until ***A*** dies.

2. The life estate is still a favorite of farm country.

E. Oil & Gas Development of the Concurrently-Owned Property (Joint Tenancy and Tenancy in Common)

1. The two basic issues:

   a. Who has the power to authorize development of the oil and gas in the land?

   b. When land is developed, how will the minerals, or mineral revenue, be divided among the parties?

2. **The Development Issue.** Any co-owner (joint tenant or tenant in common) can authorize development of the oil and gas resource without the consent of other co-owners. ***Compton v. People's Gas Co.***, 89 P. 1039 (Kan. 1907).

   a. Kansas follows a pro-development rule designed to allow each co-owner to develop their property or authorize others to develop it for them. ***Mobil Oil Corp. v. Kansas Corp. Comm'n***, 608 P.2d 1325, 1336 (Kan. 1980) (KCC required to consider 4/7ths consenting interest in assigning allowable to well; nonconsenting 3/7ths interest could not prevent KCC from assigning allowable for 4/7ths interest).

   b. The same rule is applied to co-owners of leasehold interests. ***Prewett v. Van Pelt***, 235 P. 1059 (Kan. 1925) (owner of 1/8th working interest had right to enter lease to develop and produce oil and gas).

3. **The Accounting Issue.** The developing co-owner's obligation to the non-developing co-owners is to recognize their interest and account to them for any production obtained from the land they own. Failure to recognize a co-owner's rights would be an unlawful "ouster." ***Scantlin v. Allison***, 4 P. 618 (Kan. 1884).

   a. The obligation is to account to the nonconsenting co-owner for their proportionate share of the reasonable development costs, and revenue from the well, which is producing oil or gas. ***Krug v. Krug***, 618 P.2d 323, 325 (Kan. Ct. App. 1980).

   b. Burden is on producing co-owner to establish the costs attributable to development. ***Johnson v. Gas Co.***, 135 P. 589 (Kan. 1913).

   c. The nonconsenting co-owner is a carried interest to the extent there is production from the well to recover their share of development costs, and then pay to them their net share of production proceeds.

   d. To date the case law indicates that accountings will be done on a well-by-well basis. ***Davis v. Sherman***, 86 P.2d 490 (Kan. 1939) (well #1 was a producer, well #2 was a dry hole, costs associated with well #2 could not be recovered from production from well #1). *See* **Handbook**, pp. 4-29 to 4-32.

   e. Theory used to require compensation of the nonconsenting co-owner: unjust enrichment. "The extent to which a cotenant can seek proportionate reimbursement for a dry hole drilled to prevent drainage or secure other rights of the parties will apparently be allowed, if at all, only when the drilling cotenant can show the other cotenants would be unjustly enriched." **Handbook**, p. 4-31.

4. **Ratification of the Oil and Gas Lease by the Nonconsenting Co-owner.** The industry custom and usage associated with oil and gas leases provides the nonconsenting co-owner with an opportunity to ratify a lease given by the consenting co-owners.

   a. Typically the nonconsenting co-owner would do this on a high-cost, low-production well that may not pay-out, or may take years to pay out. Ratifying the lease makes them a royalty owner entitled to immediate revenue from any production.

   b. Lease forms are set up to have each lessor purport to lease 100% of the minerals and then rely upon a proportionate reduction clause to

define their precise entitlement to royalty and other lease benefits.

c. **The Shell form** of Oil and Gas Lease is consistent with this analysis: ¶¶ 1 (granting clause), 6 (proportionate reduction clause).

¶ 6. "In the event said Lessor owns a less interest in the above described land than the entire and undivided fee simple estate therein then the royalties and any other payments herein provided [bonus?] shall be paid to said Lessor only in the proportion which his interest bears to the whole and undivided fee; . . . ."

d. If a lessor enters into the Shell form lease, for a $100,000 bonus, which is paid, and it turns out they only own a 50% interest in the oil and gas, will ¶ 6 allow Shell to demand repayment of $50,000 of the bonus money?

(1) There are Kansas cases that would support Shell's demand for repayment of bonus (or payment of a proportional bonus initially), even without the broader "any other payments herein provided" language in the lease.

(2) Question: is bonus an "any other payments herein provided" or does that refer to clauses that specify a payment, such as the shut-in royalty clause?

e. Consider the more narrow wording of this proportionate reduction (lesser interest) clause: "In case said lessor owns a less interest in the above described land than the entire and undivided fee simple estate therein, ***then the royalties, including substitute gas royalty, and rentals herein provided for*** shall be paid the said lessor only in the proportion that his interest bears to the whole and undivided fee . . ."

(1) What is the effect of a proportionate reduction clause on the promised bonus? ***Barker v. Boyer***, 794 P.2d 322, 324 (Kan. Ct. App. 1990) ("The specific wording of the lesser interest clause also applied to the *bonus* paid for the execution of a lease and the delay rental paid thereunder.") (emphasis added). The clause in *Barker* stated: "If said Lessor owns a less interest in the above-described land than the entire and undivided fee simple estate therein, then the ***royalties and rentals*** herein provided shall be paid the Lessor only in the proportion which his interest bears to the whole and undivided fee." *Id.* at 323 (emphasis added). Court cites

Brooks v. Mull as authority for the bonus *dicta*. Court in *Barker* also states: "It is *universally agreed* that the lesser interest clause acts on the *bonus*, delay rentals, and the lessor's royalty payable under an oil and gas lease." *Id.* at 324. (Emphasis added). Think so?

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

f. **What do the landmen tell the prospective lessor about proportionate reduction of bonus?** You offer me $100,000, either pay $100,000 or reject my title? No option to pay $50,000 and lock-in my one-half interest?

5. **Partition. The ultimate right of any co-owner.** In Kansas, in addition to the common law there are statutory procedural and substantive rights. K.S.A. §60-1003 provides:

Chapter 60.--PROCEDURE, CIVIL

Article 10.--ACTIONS RELATING TO PROPERTY

60-1003. Partition. (a) *Petition.* (1) When the object of the action is to effect a partition of personal or real property ***or an estate or interest created by an oil, gas or mineral lease or an oil or gas royalty***, the petition must describe the property and the respective interests of the owners thereof, if known.

(2) If the number of shares or interests is known, but the owners thereof are unknown, or if there are, or are supposed to be, any interests which are unknown, contingent or doubtful, these facts must be set forth in the petition

with reasonable certainty.

(3) Persons claiming or having a specific or general lien upon all or any portion of the property, may be made parties.

(4) An allegation of ownership of an interest implies an allegation of right to possession of the property, and it is not necessary to claim the remedy of ejectment in an action for partition.

(b) *Answer.* The answers of the defendants shall include allegations of the nature and extent of their respective interests. They may also deny the interests of any of the plaintiffs, or any of the defendants. Any claim of adverse possession shall be affirmatively pleaded and the burden of proving the same is on the defendant.

(c) *Procedure.* (1) *Order of partition.* ***The judge shall first determine and make an order specifying the interest of the respective parties and directing partition.***

(2) *Commissioners.* Upon making an order of partition, the judge shall appoint three (3) commissioners to partition the property among the parties according to their respective interests, ***but if such partition cannot be made without manifest injury, or is for any reason impracticable, the commissioners shall appraise the value of the property***, valuing each tract separately, if more than one, and report their conclusions to the court.

(3) *Exceptions to commissioner's report.* ***Any party may file exceptions to the commissioners' report and the judge may, after hearing with reasonable notice to all parties affected approve or disapprove the same***, or make such modifications as justice and equity may require, including an order requiring specific portions of the property to be awarded to specific parties, or direct such further proceedings as the judge deems equitable, but if no exceptions are filed to the commissioners' report as to division in kind the judge shall so enter judgment in accordance with the report.

(4) *Election or sale.* ***Where the property is not subject to partition in kind, any one or more of the parties may elect within a time so fixed by the judge to take the property or any separate tract at the appraised value, but if none of the parties elect to so take the property, or two or more elect to so take, in opposition to each other, the judge shall order the sheriff to sell it in the manner provided for sale of property on execution.*** No sale shall be made at less than two-thirds of the valuation placed upon the property by the commissioners.

(5) *Costs and fees.* The court making partition shall tax the costs, ***attorney***

fees and expenses, including an allowance for preparation or bringing up to date of an abstract of title or title insurance to the real estate involved in the action, which may accrue in the action, and apportion the same among the parties according to their respective interests, and may award execution therefor, as in other cases.

(d) *General powers of judge.* The court shall have full power to make any order not inconsistent with the provisions of this article that may be necessary to make a just and equitable partition between the parties, and to secure their respective interests, ***or may refuse partition if the same would result in extraordinary hardship or oppression***.

History: L. 1963, ch. 303, 60-1003; Jan. 1, 1964.

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6. The right to partition can be waived by express or implied agreement.

   a. Express agreement: A.A.P.L. Form 610 – Model Form Operating Agreement – 1989, p. 15, Art. VIII., § E., lines 29-31: "If permitted by the laws of the state or states in which the property covered hereby is located [permitted in Kansas], each party hereto owning an undivided interest in the Contract Area waives any and all rights it may have to partition and have set aside to it in severalty its undivided interest therein."

   b. Implied agreement: ***Gore v. Beren***, 867 P.2d 330 (Kan. 1994) (agreement among cotenants containing a right of first refusal constituted an implied waiver of their right to partition).

7. Partition can be a useful device for getting rid of many cotenants. A particularly bad (incorrect) decision of the Kansas Supreme Court recently upheld a partition action where the parties made no effort to give notice to all the cotenants. ***McGinty v. Hoosier***, 239 P.3d 843 (Kan. 2010).

   a. McGinty sought to quiet title to an interest they acquired through a 1974 partition action in which, as the court states: "The owners of the remaining 50% of the mineral interest were not personally served in the action, were apparently not served by publication, and did not participate in the action partitioning the subject tract."

   b. The 1974 sheriff's deed did not mention minerals but conveyed the land by legal description to a third party purchaser, McGinty's

predecessor in interest, who was the successful bidder at the partition sale.

c. The court held McGinty received whatever minerals the parties had to convey by operation of K.S.A. § 58-2202.

d. Justice Johnson, writing for the court, takes the opportunity to "spell it out for the defendants" that McGinty received not only the surface estate but also 50% of the minerals.

e. Although there is some suggestion in the opinion that the interests of the cotenants who did not receive notice in the 1973 partition hearing were not represented in the present quiet title action, that was not the case. In some instances the successors to the cotenants were directly involved, and in other instances their interests were represented by Coral Production Corp. that held oil and gas leases from the interest owners, as well as production proceeds awaiting distribution pending the determination of title.

f. The court holds the trial court, in 1974, had jurisdiction to affect the title of the cotenants it had before it – even though other cotenants had not been given notice of the partition proceedings and an opportunity to be heard.

g. The court states: "The challenger must show that the nonjoined person or entity was a necessary or indispensable party to the action, *i.e.*, that the property interests of the nonjoined party were adversely affected by the judgment partitioning the named parties' property interests."

(1) "[W]e discern no compelling policy reason to create a rule in this state that forces a property owner to join all owners of all property interests in order to partition the particular portion of the property in which the petitioner has an interest."

(2) "Accordingly, we decline to create a new mandatory joinder requirement for partition actions in this state. The efficacy of a judgment in a partition action in which less than all owners are named parties must turn on whether the property interest of a nonjoined owner has been prejudiced or adversely affected by the partition judgment."

h. **COMMENT:** The essence of cotenancy is that ***every*** cotenant has a vested property right in participating in ***any*** partition of the co-owned property.

(1) Although courts should be reluctant to invalidate proceedings that are over 30 years old, the nature of mineral ownership is such that the Kansas Legislature, as a matter of public policy, has refused to apply time-based curative procedures to mineral title defects.

(2) If notice was not provided to a cotenant, either personally or by publication, the proceeding should be a nullity because there is no way you can conduct a partition proceeding without attempting to join all cotenants.

i. Cotenants have an undivided interest in the whole such that not even a part of the whole should be subjected to a judicial sale without joining all cotenants.

(1) The cotenant may want to sell their interest at the same time – a sale of 100% may provide the only opportunity to realize maximum value of all undivided interests.

(2) The cotenant may want to buy the other interests.

(3) The cotenant may want to exercise their statutory right to object to any sale as being "oppressive." K.S.A. § 60-1003(d).

(4) The cotenant may want to argue for partition in kind of the whole.

(5) The cotenant may want to make sure they are involved to avoid collusive action by the other cotenants.

j. The cotenant's rights can be protected only if they are given notice and an opportunity to be heard. It will be interesting to see what sort of maneuvering the court's opinion invites.

F. Oil & Gas Development of the Successively-Owned Property (Life Tenancy)

1. The two basic issues:

   a. Who has the power to authorize development of the oil and gas in the land?

   b. When land is developed, how will the minerals, or mineral revenue, be divided among the parties?

2. **The Development Issue.** Neither the life tenant nor the remainder or reversion owner can independently develop, or authorize development, of the land.

   a. The deed creating the interests can always provide that one or the other party will have independent development rights.

   b. However, often the deed does not address the issue and therefore:

      (1) If the life tenant develops without the consent of the remainder or reversion owner, it will constitute waste against the future interest. **K.S.A. § 58-2523** ("A person seized of an estate in remainder or reversion may maintain an action for waste or trespass for injury to the inheritance, notwithstanding an intervening estate for life or years.").

      (2) The remainder or reversion owner has no present right of possession to enter the property, or authorize others to enter.

   c. In ***Burden v. Gypsy Oil Co.***, 40 P.2d 463, 467 (Kan. 1935), the court, reviewing the rules in this area, stated:

      "[A] life tenant has no right to exploit the gas and oil reserves of the property for his own benefit, or to authorize, by lease or otherwise, another to do so, where such exploitation had not been begun or authorized before the commencement of the life estate and no such right has been conferred upon him by the will or other instrument by which the life estate was created, or by agreement or consent of the remainderman entitled to the eventual estate."

   d. Need the consent of the present and future interest owners to engage in oil and gas operations.

e. *See* **Handbook** at pp. 4-33 to 4-38.

3. **The Accounting Issue.** If the property was not under lease, or being developed, at the time the life estate was created, and the deed creating the life estate is silent regarding development, but the life tenant and remainderman (or reversionary interest owner) authorize development of the property – without stating how leasing benefits should be shared – then the following rules apply:

   a. Must classify the bonus, royalty, shut-in royalty, and delay rental as either principal (corpus) or income.

   b. Income is payable to the life tenant, principal is invested for the eventual distribution to the remainderman (or reversionary interest owner). However, interest earned on the invested principal is paid to the life tenant.

   c. Delay rental is deemed income; that is probably how shut-in royalty will be treated since it is a payment unrelated to production of oil or gas from the property.

   d. Royalty reflects a depreciation of the corpus so it is principal that must be invested and held for owner of the future interest. Interest earned on the invested royalty proceeds is paid to the life tenant.

   e. Courts go both ways on bonus. Some treating it as income, others as principal. Kansas has not addressed the issue. However, the larger the bonus, the more likely it will be considered principal that must be invested and held for the owner of the future interest and income paid to the life tenant.

   f. **Open mine doctrine.** If the property was leased at the time the life tenancy was created, and production is obtained under that lease (whether before of after the life estate is created), all the lease benefits belong to the life tenant. The owner of the future interest gets nothing while the life tenant is alive. ***Kimbark Exploration Co. v. Von Lintel***, 391 P.2d 55, 58 (Kan. 1964).

   g. **Uniform Principal and Income Act.** The current version only applies to a trustee administering a trust, or an executor or administrator of a decedent's estate administering the estate. For a life estate created by grant, the UPIA will not apply.

Chapter 58.--PERSONAL AND REAL PROPERTY
Part 1.--DEFINITIONS AND FIDUCIARY DUTIES
Article 9.--UNIFORM PRINCIPAL AND INCOME ACT (1997)

58-9-101. Short title. This act shall be known and may be cited as the uniform principal and income act (1997).

History: L. 2000, ch. 61, § 1; July 1.

58-9-102. Definitions. As used in this act: . . . .

(2) "Beneficiary" includes, in the case of a decedent's estate, an heir, legatee, and devisee and, in the case of a trust, an income beneficiary and a remainder beneficiary.

(3) "Fiduciary" means a personal representative or a trustee. The term includes an executor, administrator, successor personal representative, special administrator, and a person performing substantially the same function. . . .

History: L. 2000, ch. 61, § 2; July 1.

58-9-103. Fiduciary duties; general principles. (a) In allocating receipts and disbursements to or between principal and income, and with respect to any matter within the scope of parts 2 and 3, a fiduciary:

(1) ***Shall administer a trust or estate in accordance with the terms of the trust or the will, even if there is a different provision in this act***;

(2) may administer a trust or estate by the exercise of a discretionary power of administration given to the fiduciary by the terms of the trust or the will, even if the exercise of the power produces a result different from a result required or permitted by this act;

(3) ***shall administer a trust or estate in accordance with this act if the terms of the trust or the will do not contain a different provision or do not give the fiduciary a discretionary power of administration***; and

(4) shall add a receipt or charge a disbursement ***to principal*** to the extent that the terms of the trust and this act do not provide a rule for allocating the receipt or disbursement to or between principal and income.

(b) In exercising the power to adjust under subsection (a) of K.S.A. 58-9-104, and amendments thereto, or a discretionary power of administration regarding a matter within the scope of this act, whether granted by the terms of a trust, a will, or this act, a fiduciary shall administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or the will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries. A determination in accordance with this act is presumed to be fair and reasonable to all of the beneficiaries.

History: L. 2000, ch. 61, § 3; July 1.

58-9-411. Minerals, water and other natural resources. (a) To the extent that a trustee accounts for receipts from an interest in minerals or other natural resources pursuant to this section, the trustee shall allocate them as follows:

(1) If received as ***nominal delay rental*** or nominal annual rent on a lease, a receipt must be allocated to ***income***.

(2) If received from a production payment, a receipt must be allocated to income if and to the extent that the agreement creating the production payment provides a factor for interest or its equivalent. The balance must be allocated to principal.

(3) If an amount received as a ***royalty, shut-in-well payment, take-or-pay payment, bonus, or delay rental is more than nominal, 15 percent must be allocated to principal and the balance [85%] to income***.

(4) If an amount is received from a working interest or any other interest not provided for in subsection (1), (2), or (3), 15 percent of the net amount received must be allocated to principal and the balance [85%] to income.

(b) An amount received on account of an interest in water that is renewable must be allocated to income. If the water is not renewable, 90 percent of the amount must be allocated to principal and the balance to income.

(c) ***This act applies whether or not a decedent or donor was extracting minerals, water, or other natural resources before the interest became subject to the trust***.

(d) If a trust owns an interest in minerals, water, or other natural resources on the effective date of this act, the trustee may allocate receipts from the interest as provided in this act or in the manner used by the trustee before the effective date of this act. If the trust acquires an interest in minerals, water, or other natural resources after the effective date of this act, the trustee shall allocate receipts from the interest as provided in this act.

History: L. 2000, ch. 61, § 20; L. 2003, ch. 38, § 1; July 1.

58-9-601. Application of act. ***Except as expressly provided in a will or terms of the trust or this act, this act applies to every trust or decendent's estate existing on the effective date of this act.***

History: L. 2000, ch. 61, § 31; July 1.

G. An Exercise: Development of Property That is Both Concurrently-Owned and Successively-Owned

PROPERTY EXAMINATION
QUESTION #1

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

DEED

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

Signed this 10th day of September 2005.

DEED

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

Signed this 15th day of September 2005.

On October 10, 2007 Cheryl entered into an oil and gas lease with Acme Oil Company which leases "the undivided one-half interest Cheryl Stice owns in the South Half of Section 24, Township 11 South, Range 15 East of the 6th Principal Meridian, in Shawnee County, Kansas." The oil and gas lease authorizes Acme to enter the South Half of Section 24 and explore for, extract, and remove oil and gas from the South Half of Section 24. The lease obligates Acme to pay Cheryl a royalty equal to 1/8th of the current market value, at the time of extraction, of all oil and gas produced from the land, to be proportionately reduced to reflect Cheryl's actual ownership in the oil and gas (1/8 x Cheryl's ½ interest = 1/16th royalty). The lease expressly authorizes Acme to enter the surface of the leased land to conduct all necessary oil and gas development operations.

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

ACME OIL COMPANY
1542 Crosscoach Lane
Katy, Texas 77651

December 4, 2007

Robert Riley
[correct address]

Mark Allai
[correct address]

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

Dear Mr. Riley and Mr. Allai:

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

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

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

Sincerely,

Acme Oil Company
[Signed by Mark]

_____
By: Mark Loy, President

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

QUESTION #1

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

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

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

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

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

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

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

G. A. & B.

H. A., B., & F.

IV. MARRIAGE AND PROPERTY OWNERSHIP

A. Homestead Property

1. **Kan. Const. Art. 15, § 9. Homestead exemption.** A homestead to the extent of one hundred and sixty acres of farming land, or of one acre within the limits of an incorporated town or city, ***occupied as a residence by the family of the owner***, together with all the improvements on the same, shall be exempted from forced sale under any process of law, ***and shall not be alienated without the joint consent of husband and wife, when that relation exists***; but no property shall be exempt from sale for taxes, or for the payment

of obligations contracted for the purchase of said premises, or for the erection of improvements thereon: Provided, That provisions of this section shall not apply to any process of law obtained by virtue of a lien given by the consent of both husband and wife: And provided further, That ***the legislature by an appropriate act or acts, clearly framed to avoid abuses, may provide that when it is shown the husband or wife while occupying a homestead is adjudged to be insane, the duly appointed guardian of the insane spouse may be authorized to join with the sane spouse in executing a*** mortgage upon the homestead, renewing or refinancing an encumbrance thereon which is likely to cause its loss, or in executing a ***lease thereon authorizing the lessee to explore and produce therefrom oil, gas***, coal, lead, zinc, or other minerals.

2. Granting an oil and gas lease is an "alienation" of the homestead which requires joint consent of husband and wife. ***Palmer v. Parish***, 59 P. 640 (Kan. 1900).

3. The Kansas Constitution was amended in 1944 to authorize a procedure to obtain the consent for an "insane spouse." This resulted in the procedures set out at **K.S.A. §§ 59-2314 to 59-2322.** Generally provides the district court, in a court proceeding, can authorize the incapacitated spouse's conservator to execute an oil and gas lease. However, a guardian *ad litem* must be appointed to act on behalf of the incapacitated spouse and to "make an independent investigation of the facts and representations made in the petition" and report his or her findings to the court. **K.S.A. § 59-2317.**

   a. Proceeds from leasing are exempt from creditors to the same extent as the other homestead property. **K.S.A. § 59-2319.**

   b. Involved process, requiring a court proceeding.

4. **Durable Power of Attorney.** It is now possible for an attorney-in-fact to grant rights in a spouse's homestead property without following the judicial procedure. However, the power of attorney must contain explicit language ***and*** a separate writing must be prepared making specific findings.

   a. In the "general powers" portion of the **Kansas Power of Attorney Act, K.S.A. §§ 58-650 to 58-665**, if the power of attorney expressly references homestead rights, and otherwise complies with the drafting requirements of **K.S.A. § 58-654(f)(10) (Supp. 2012)**, then the attorney-in-fact can execute an oil and gas lease, covering homestead property, and bind the incapacitated spouse.

b. **K.S.A. § 58-654(f)(10) (Supp. 2012)** provides:

"(f) Any power of attorney, whether or not it grants general powers for all subjects and purposes or with respect to express subjects or purposes, shall be construed to grant power or authority to an attorney in fact to carry out any of the actions described in this subsection ***only if the actions are expressly enumerated and authorized in the power of attorney***. Any power of attorney may grant power or authority to an attorney in fact to carry out any of the following actions if the actions are expressly authorized in the power of attorney:

(10) ***to give consent on behalf of the principal to the sale, gift, transfer, mortgage or other alienation of the principal's homestead or interest therein if:***

(A) ***The principal's spouse***, personally or through such spouse's attorney in fact, ***has also consented to such alienation***;

(B) ***the power of attorney specifically describes the homestead by reference to a legal description and the street address of the property***; and

(C) ***the principal's spouse, in a written document duly acknowledged by the spouse, has stated such spouse's consent that the attorney in fact may alienate the interests, in whole or in part, of the principal in the described homestead and, further, the spouse agrees that the consent of the attorney in fact will constitute the consent of the principal required by Article 15, Section 9 of the Kansas Constitution***. Nothing herein shall be construed as a limitation or abridgement of the right of the spouse of the principal to consent or withhold such spouse's consent to the alienation of the spouse's homestead, or any rights therein, under Article 15, section 9 of the Kansas Constitution; . . . ."

B. Statutory Dower and Curtesy

1. At common law "dower" provided certain protections to the wife in the marital relationship while "curtesy" provided for rights in the husband. Today, these common law protections, or marital estates, are reflected in statutes.

2. **K.S.A. § 59-505** provides:

Except as provided further, the surviving spouse shall be entitled to receive

one-half of all real estate of which the decedent at any time during the marriage was seized or possessed and to the disposition whereof the survivor shall not have consented in writing, or by a will, or by an election as provided by law to take under a will, except such real estate as has been sold on execution or judicial sale, or taken by other legal proceeding. The surviving spouse shall not be entitled to any interest under the provisions of this section in any real estate of which such decedent in such decedent's lifetime made a conveyance, when such spouse at the time of the conveyance was not a resident of this state and never had been during the existence of the marriage relation. The spouse's entitlement under this section shall be included as part of the surviving spouse's property under K.S.A. 59-6a207, and amendments thereto.

a. This provision applies to homestead, and non-homestead property.

b. This is one of the most common title problems: either a spouse failed to join in the grant, or the document fails to indicate the grantor's marital status. Merely mentioning the property is being conveyed by "David E. Pierce and Martha A. Pierce" creates a problem unless we know they are husband and wife, instead of, for example, brother and sister, in which case they each may have a spouse that needs to join in the conveyance.

C. Divorce Rights

1. Although Kansas is not a community property state, with homestead rights and **K.S.A. § 59-505** rights, and spousal elective share rights under **K.S.A. §§59-6a201 to 59-6a217**, it would be inaccurate to say that any spouse in Kansas truly has "separate" property – particularly when it comes to divorce.

2. **K.S.A. § 23-2601. Married persons; separate property; marital property.** "The property, real and personal, which any person in this state may own at the time of the person's marriage, and the rents, issues, profits or proceeds thereof, and any real, personal or mixed property which shall come to a person by descent, devise or bequest, and the rents, issues, profits or proceeds thereof, or by gift from any person except the person's spouse, ***shall remain the person's sole and separate property, notwithstanding the marriage, and not be subject to the disposal of the person's spouse or liable for the spouse's debts.***"

   History: L. 2011, ch. 26, § 3; July 1

3. **K.S.A. § 23-2801. Marital property.** "(a) All property owned by married persons, including the present value of any vested or unvested military retirement pay, or, for divorce or separate maintenance actions commenced on or after July 1, 1998, professional goodwill to the extent that it is marketable for that particular professional, whether described in K.S.A. 2011 Supp. 23-2601, and amendments thereto, or acquired by either spouse after marriage, and whether held individually or by the spouses in some form of co-ownership, such as joint tenancy or tenancy in common, ***shall become marital property at the time of commencement by one spouse against the other of an action in which a final decree is entered for divorce, separate maintenance, or annulment.***

(b) Each spouse has a common ownership in marital property which vests at the time of commencement of such action, the extent of the vested interest to be determined and finalized by the court, pursuant to K.S.A. 2011 Supp. 23-2802, and amendments thereto."

4. **K.S.A. § 23-2802. Division of property.** (a) The decree shall divide the real and personal property of the parties, including any retirement and pension plans, ***whether owned by either spouse prior to marriage, acquired by either spouse in the spouse's own right after marriage or acquired by the spouses' joint efforts***, by: (1) A division of the property in kind; (2) awarding the property or part of the property to one of the spouses and requiring the other to pay a just and proper sum; or (3) ordering a sale of the property, under conditions prescribed by the court, and dividing the proceeds of the sale. . ."

V. INTESTATE AND TESTATE TRANSFERS

A. Intestate Succession Statutes

1. General observations: no life estates, only tenants in common when more than one person is entitled to receive an interest in property.

2. Spouse, no children, all to spouse. **K.S.A. § 59-504.**

3. Child, no spouse, all to child. **K.S.A. § 59-506.**

3. Spouse and one child. 50/50 as cotenants. **K.S.A. § 59-504 & § 55-506.**

4. Spouse and five children. 50% to spouse, remaining 50% divided equally among children (10% each), as cotenants. **K.S.A. § 59-506.**

5. Grandchildren take by representation through their deceased parents. Spouse

and five children, but one child predeceased survived by his or her three children: Spouse (50%), Four Living Children (10%), Three Grandchildren (Deceased Child's Children) (1/3rd of 10% each). **K.S.A. § 59-504 & § 55-506.**

6. If the decedent has no descendants, then you ascend through the decedent's parents and to collateral heirs. **K.S.A. § 59-507 & § 55-508.**

B. Probate Code

1. To be effective, a will must be probated. **K.S.A. § 59-616.**

2. Will must be offered to probate within six months after death of the testator. **K.S.A. § 59-617.** Exception for innocent parties when there has been a knowing withholding of the will from probate by others. **K.S.A. § 59-618.**

VI. AUTHORITY TO CONVEY AND CONTRACT

A. Individuals and Powers of Attorney

1. Age of majority in Kansas: 18 (16 if married, or have been married).

2. **K.S.A. § 38-101. Period of minority.** The period of minority extends in all persons to the age of eighteen (18) years, except that every person sixteen (16) years of age or over who is or has been married shall be considered of the age of majority in all matters relating to contracts, property rights, liabilities and the capacity to sue and be sued.

3. **K.S.A. § 38-108. District court may confer rights of majority.** "That the district courts for the several counties in this state shall have authority to confer upon minors the rights of majority, concerning contracts and real and personal property, and to authorize and empower minors to purchase, hold, possess and control in their own person and right, and without the intervention or control of a guardian or trustee, any goods, chattels, rights, interests in lands, tenements and effects by such minor lawfully acquired or inherited; and such minor shall have full power to hold, convey and dispose of the same, and to make contracts and be subject to all the liabilities incident thereto, sue and be sued, and in all respects to exercise and enjoy all rights of property and of contracts in the same manner and to the same extent as persons at the age of majority."

4. Appointment of Guardian or Conservator for Minors and "Impaired" Individuals. **K.S.A. §§ 59-3050 to 59-3097.**

5. "Appropriate alternative" to a guardian or conservator may include "use of a legal device or representative" which enables a person with an impairment to contract and convey: to include a " power of attorney" and "durable power of attorney." **K.S.A. § 59-3051(b).**

6. Kansas Power of Attorney Act, **K.S.A. §§ 58-650 to 58-665.**

   a. **K.S.A. § 58-651. Definitions.** "As used in the Kansas power of attorney act:

   (a) "Attorney in fact" means an individual, corporation or other legal entity appointed to act as agent of a principal in a written power of attorney. . . .

   (d) "Durable power of attorney" means a written power of attorney in which the authority of the attorney in fact does not terminate in the event the principal becomes disabled or in the event of later uncertainty as to whether the principal is dead or alive and which complies with subsection (a) of K.S.A. 58-652, and amendments thereto, or is durable under the laws of any of the following places:

   (1) The law of the place where executed;

   (2) the law of the place of the residence of the principal when executed; or

   (3) the law of a place designated in the written power of attorney if that place has a reasonable relationship to the purpose of the instrument. . . .

   (i) "Power of attorney" means a written power of attorney, either durable or nondurable. . . ."

   b. "General" means "General." **K.S.A. §58-654. General powers.** "(a) A principal may delegate to an attorney in fact in a power of attorney ***general powers to act in a fiduciary capacity on the principal's behalf with respect to all lawful subjects and purposes or with respect to one or more express subjects or purposes.*** A power of attorney with general powers ***may be durable or nondurable.***

   (b) If the power of attorney states that general powers are granted to the attorney in fact and further states in substance that it grants power

to the attorney in fact to act with respect to all lawful subjects and purposes or that it grants general powers for general purposes or does not by its terms limit the power to the specific subject or purposes set out in the instrument, then ***the authority of the attorney in fact acting under the power of attorney shall extend to and include each and every action or power which an adult who is not disabled may carry out through an agent specifically authorized in the premises, with respect to any and all matters whatsoever, except as provided in subsection (f) and (g)***. . . ."

c. **K.S.A. § 58-658. Exemption of third persons from liability.** "(a) A third person, who is acting in good faith, without liability to the principal or the principal's successors in interest, may rely and act on any power of attorney executed by the principal. ***A third person, with respect to the subjects and purposes encompassed by or separately expressed in the power of attorney, may rely and act on the instructions of or otherwise contract and deal with the principal's attorney in fact or successor attorney in fact and, in the absence of actual knowledge, as defined in subsection (c), is not responsible for determining and has no duty to inquire as to any of the following***:

(1) The authenticity of a copy of a power of attorney furnished by the principal's attorney in fact or successor;

(2) the validity of the designation of the attorney in fact or successor;

(3) whether the attorney in fact or successor is qualified to act as an attorney in fact for the principal;

(4) the propriety of any act of the attorney in fact or successor in the principal's behalf, including, but not limited to, whether or not an act taken or proposed to be taken by the attorney in fact, constitutes a breach of any duty or obligation owed to the principal, including, but not limited to, the obligation to the principal not to modify or alter the principal's estate plan or other provisions for distributions of assets at death, as provided in subsection (a) of K.S.A. 58-656, and amendments thereto;

(5) whether any future event, condition or contingency making effective or terminating the authority conferred in a power of attorney has occurred;

(6) whether the principal is disabled or has been adjudicated disabled;

(7) whether the principal, the principal's legal representative or a court has given the attorney in fact any instructions or the content of any instructions, or whether the attorney in fact is following any instructions received;

(8) whether the authority granted in a power of attorney has been modified by the principal, a legal representative of the principal or a court;

(9) whether the authority of the attorney in fact has been terminated, except by an express provision in the power of attorney showing the date on which the power of attorney terminates;

(10) whether the power of attorney, or any modification or termination thereof, has been recorded, ***except as to transactions affecting real estate***;

(11) whether the principal had legal capacity to execute the power of attorney at the time the power of attorney was executed;

(12) whether, at the time the principal executed the power of attorney, the principal was subjected to duress, undue influence or fraud, or the power of attorney was for any other reason void or voidable, if the power of attorney appears to be regular on its face;

(13) whether the principal is alive;

(14) whether the principal and attorney in fact were married at or subsequent to the time the power of attorney was created and whether an action for annulment, separate maintenance or divorce has been filed by either party; or

(15) the truth or validity of any facts or statements made in an affidavit of the attorney in fact or successor with regard to the ability or capacity of the principal, the authority of the attorney in fact or successor under the power of attorney, the happening of any event or events vesting authority in any successor or contingent attorney in fact, the identity or authority of a person designated in the power of attorney to appoint a substitute or successor attorney in fact or that the principal is alive.

(b) ***A third person, in good faith*** and without liability to the principal or the principal's successors in interest, even with knowledge that the

principal is disabled, ***may rely and act on the instructions of or otherwise contract and deal with the principal's attorney in fact or successor attorney in fact acting pursuant to authority granted in a durable power of attorney.***

(c) ***A third person that conducts activities through employees shall not be charged under this act with actual knowledge of any fact relating to a power of attorney, nor of a change in the authority of an attorney in fact, unless the information is received at a home office or a place where there is an employee with responsibility to act on the information, and the employee has a reasonable time in which to act on the information using the procedures and facilities that are available to the third person in the regular course of its operations.***

(d) A third person, when being requested to engage in transactions with a principal through the principal's attorney in fact, may: (1) Require the attorney in fact to provide specimens of the attorney in fact's signature and any other information reasonably necessary or appropriate in order to facilitate the actions of the third person in transacting business through the attorney in fact; (2) require the attorney in fact to indemnify the third person against forgery of the power of attorney, by bond or otherwise. If the power of attorney is durable as defined in subsection (a) of K.S.A. 58-652, and amendments thereto, and if either the principal or the attorney in fact seeking to act is and has been a resident of this state for at least two years, and if the attorney in fact has executed in the name of the principal and delivered to the third person an indemnity agreement reasonably satisfactory in form to such third person, no such bond shall be required; and (3) prescribe the place and manner in which the third person will be given any notice respecting the principal's power of attorney and the time in which the third person has to comply with any notice."

d. **K.S.A. § 58-659. Termination of power of attorney; liability between principal and third persons.** "(a) As between the principal and third persons, the authority granted in a power of attorney shall terminate on the date of termination, if any, ***set out in the power of attorney or on the date when the third person acquires actual knowledge*** of the death of the principal or that the authority granted in the power of attorney has been suspended, modified or terminated.

(b) ***As between the principal and third persons, the acts and transactions of an attorney in fact are binding on the principal and***

the principal's successors in interest in any situation in which a third person is entitled to rely under K.S.A. 58-658, and amendments thereto.

(c) This section shall not prohibit the principal, acting individually, and a third person from entering into a written agreement that sets forth their duties and liabilities as between themselves and their successors, and which expands or limits the application of this act, ***except that no agreement shall limit or restrict the right of the principal to act with respect to the third person through an attorney in fact appointed in a power of attorney***."

7. The statutes are designed to encourage third parties to deal with an attorney in fact acting on behalf of their principal under a power of attorney.

B. Trusts

1. Trustee powers are conferred, defined, and limited by the trust agreement ("trust instrument") creating the trust. If the trust agreement is silent on the matter, you next turn to state statutory law for guidance.

2. **Kansas Uniform Trust Code, K.S.A. §§ 58a-101 to 58a-1107.**

   a. **K.S.A. § 58a-815. General powers of trustee.** "(a) A trustee, without authorization by the court, may exercise:

   (1) ***Powers conferred by the terms of the trust***; and

   (2) except as limited by the terms of the trust:

   (A) ***All powers over the trust property which an unmarried competent owner has over individually owned property***;

   (B) any other powers appropriate to achieve the proper investment, management, and distribution of the trust property; and

   (C) ***any other powers conferred by this code***.

   (b) The exercise of a power is subject to the fiduciary duties prescribed by this article."

   b. **K.S.A. § 58a-816. Specific powers of trustee.** "Without limiting the authority conferred by K.S.A. 58a-815, and amendments thereto, a

trustee may: . . .

(9) enter into a lease for any purpose as lessor or lessee, including a lease or other arrangement for exploration and removal of natural resources, with or without the option to purchase or renew, for a period within or extending beyond the duration of the trust; . . . .

(25) sign and deliver contracts and other instruments that are useful to achieve or facilitate the exercise of the trustee's powers; . . . ."

3. Like the Power of Attorney Act, other provisions of the Kansas Uniform Trust Code are designed to protect third parties that rely upon a trustee's authority.

a. **K.S.A. § 58a-1012. Protection of person dealing with trustee.** "(a) A person other than a beneficiary who in good faith assists a trustee, or ***who in good faith and for value deals with a trustee, without knowledge that the trustee is exceeding or improperly exercising the trustee's powers is protected from liability as if the trustee properly exercised the power.***

(b) A person other than a beneficiary ***who in good faith deals with a trustee is not required to inquire into the extent of the trustee's powers or the propriety of their exercise.***

(c) A person who in good faith delivers assets to a trustee need not ensure their proper application.

(d) A person other than a beneficiary who in good faith assists a former trustee, or who in good faith and for value deals with a former trustee, without knowledge that the trusteeship has terminated is protected from liability as if the former trustee were still a trustee.

(e) Comparable protective provisions of other laws relating to commercial transactions or transfer of securities by fiduciaries prevail over the protection provided by this section.

b. **K.S.A. § 58a-1013. Certification of trust.** "(a) Instead of furnishing a copy of the trust instrument to a person other than a qualified beneficiary, the trustee may furnish to the person an acknowledged certification of trust containing the following information: . . . ."

C. Estates

1. The executor (subject to limitations stated in the will), and the administrator, are given express powers to manage and dispose of estate property in the Probate Code, **K.S.A. §§ 59-1401 to 59-1413.**

2. Express authority to enter into an oil and gas lease is found at: **K.S.A. §59-1409. Lease of property.** The executor or administrator may lease real estate in his or her possession for a term of not more than one year. ***The executor or administrator, together with the heirs and devisees having an interest therein, may lease such real estate for a term longer than one year, and they may execute an oil and gas or other mineral lease for such real estate.*** **The income from any lease, by whatever name called, shall be received by the executor or administrator as income from such property**.

   a. Regarding the last sentence, what is the meaning of the term "income"?

   b. Could this impact the Uniform Principal and Income Act allocations?

3. Special protection is provided to a third party that deals with an executor acting under an express power contained in a will. **K.S.A. § 59-1413. Sale under will; exercise of power; tax liens and claims.** "(a) ***If a will authorizes the executor to sell any property, the executor***, or an administrator with the will annexed, ***may exercise such power without any order of the district court, unless the will provides otherwise***. Subject to the limitations contained in K.S.A. 59-704, and amendments thereto, such power may be exercised at any time except when a proceeding to set aside or contest the will or to probate a later will of the decedent is pending.

   (b) ***Every conveyance of real estate of a decedent to a bona fide purchaser, pursuant to the authority of this section, shall transfer such real estate free and clear from liens and claims of all creditors of the decedent of the estate of the decedent and of the heirs, devisees and legatees of the decedent*** and any such liens or claims shall be transferred to the proceeds of such sale received by the executor or administrator making the same but such transferral shall not affect tax liens against the estate.

D. Partnerships and Other Entities

1. Kansas Uniform Partnership Act, **K.S.A. §§ 56a-101 to 56a-1305.**

2. Applies to general partnerships and the "limited liability partnerships".

3. The partnership is an "entity distinct from its partners." K.S.A. § 56a-201. Therefore, must define who can act on behalf of, and effectively bind, the entity.

4. As with any entity (governmental or non-governmental), this is initially a matter of statute, followed by an examination of the appropriate documents to trace authority to the governing body.

5. **K.S.A. § 56a-301. Partner agent of partnership.** "Subject to the effect of a statement of partnership authority under K.S.A. 56a-303:

(a) ***Each partner is an agent of the partnership for the purpose of its business.*** An act of a partner, including the execution of an instrument in the partnership name, ***for apparently carrying on in the ordinary course the partnership business or business of the kind carried on by the partnership binds the partnership***, unless the partner had no authority to act for the partnership in the particular matter and the person with whom the partner was dealing knew or had received a notification that the partner lacked authority.

(b) An act of a partner which is not apparently for carrying on in the ordinary course the partnership business or business of the kind carried on by the partnership binds the partnership only if the act was authorized by the other partners."

6. **K.S.A. § 56a-303. Statement of partnership authority.** (a) A partnership ***may*** file a statement of partnership authority, which:

(1) Must include:

(i) The name of the partnership;

(ii) the street address of its principal office and of one office in this state, if there is one;

(iii) the names and mailing addresses of all of the partners or of an agent appointed and maintained by the partnership for the purpose of subsection (b); and

(iv) the names of the partners authorized to execute an instrument transferring real property held in the name of the partnership; and

(2) may state the authority, or limitations on the authority, of some or all of the partners to enter into other transactions on behalf of the partnership and

any other matter.

(b) If a statement of partnership authority names an agent, the agent shall maintain a list of the names and mailing addresses of all of the partners and make it available to any person on request for good cause shown.

(c) If a filed statement of partnership authority is executed pursuant to subsection (c) of K.S.A. 56a-105 and states the name of the partnership but does not contain all of the other information required by subsection (a), the statement nevertheless operates with respect to a person not a partner as provided in subsections (d) and (e).

(d) Except as otherwise provided in subsection (g), a filed statement of partnership authority supplements the authority of a partner to enter into transactions on behalf of the partnership as follows:

(1) ***Except for transfers of real property***, a grant of authority contained in a filed statement of partnership authority is conclusive in favor of a person who gives value without knowledge to the contrary, so long as and to the extent that a limitation on that authority is not then contained in another filed statement. A filed cancellation of a limitation on authority revives the previous grant of authority.

(2) ***A grant of authority to transfer real property held in the name of the partnership contained in a certified copy of a filed statement of partnership authority recorded in the office for recording transfers of that real property is conclusive in favor of a person who gives value without knowledge to the contrary, so long as and to the extent that a certified copy of a filed statement containing a limitation on that authority is not then of record in the office for recording transfers of that real property.*** The recording in the office for recording transfers of that real property of a certified copy of a filed cancellation of a limitation on authority revives the previous grant of authority.

(e) A person not a partner is deemed to know of a limitation on the authority of a partner to transfer real property held in the name of the partnership if a certified copy of the filed statement containing the limitation on authority is of record in the office for recording transfers of that real property.

(f) Except as otherwise provided in subsections (d) and (e) and K.S.A. 56a-704 and 56a-805, a person not a partner is not deemed to know of a limitation on the authority of a partner merely because the limitation is contained in a filed statement.

(g) Unless earlier canceled, a filed statement of partnership authority is canceled by operation of law five years after the date on which the statement, or the most recent amendment, was filed with the secretary of state.

VII. STATUTES IMPACTING OIL & GAS DEVELOPMENT

A. Recording Statutes: Constructive Notice

1. **K.S.A. § 58-2221. Recordation of instruments conveying or affecting real estate; duties of register of deeds.** "Every instrument in writing that conveys:

(a) Real estate;

(b) ***any estate or interest created by an oil and gas lease***;

(c) any estate or interest created by any lease or easement involving wind resources and technologies to produce and generate electricity; ***or***

(d) ***whereby any real estate may be affected***, proved or acknowledged, and certified in the manner hereinbefore prescribed, may be recorded in the office of register of deeds of the county in which such real estate is situated. It shall be the duty of the register of deeds to file the same for record immediately, and in those counties where a numerical index is maintained in the register of deeds' office, the register of deeds shall compare such instrument, before copying the same in the record, with the last record of transfer in the register of deeds' office of the property described. If the register of deeds finds such instrument contains apparent errors, the register of deeds shall not record the instrument until the grantee has been notified, if such notice is reasonably possible.

The grantor, lessor, grantee or lessee or any other person conveying or receiving real property or other interest in real property upon recording the instrument in the office of register of deeds shall furnish the register of deeds the full name and last known post-office address of the person to whom the property is conveyed or such person's designee. The register of deeds shall forward such information to the county clerk of the county who shall make any necessary changes in address records for mailing tax statements."

2. **K.S.A. § 58-2222. Same; filing imparts notice.** "Every such instrument in writing, certified and recorded in the manner hereinbefore prescribed, shall, from the time of filing the same with the register of deeds for record, ***impart notice to all persons of the contents thereof; and all subsequent purchasers***

and mortgagees shall be deemed to purchase with notice."

3. **K.S.A. § 58-2223. Same; unrecorded instrument valid only between parties having actual notice.** "No such instrument in writing shall be valid, except between the parties thereto, ***and such as have actual notice thereof***, until the same shall be deposited with the register of deeds for record."

4. A grantee's rights in an unrecorded conveyance can be defeated by subsequent purchasers or lenders who lack actual notice of the conveyance.

5. ***Luthi v. Evans***, 576 P.2d 1064 (Kan. 1978) (conveyance recorded but not constructive notice because Mother Hubbard description did not provide constructive notice of unidentified properties).

6. Statutory Limitations on General Descriptions. **K.S.A. § 58-2273. Instruments purporting to cover mineral or royalty rights not owned by grantor; "mother hubbard" or other cover-all clauses.** (a) When a ***recorded deed or conveyance covering mineral or royalty rights*** purports to cover mineral or royalty rights not owned by the grantor, or such deed or conveyance ***includes a general conveyance provision, including, but not limited to, a "mother hubbard" clause or other cover-all clause, for other property conveyed by grantor and such general conveyance provision should not have been included in such deed or conveyance***, then any party with an interest in the real estate covered by such deed or conveyance may make written demand upon the grantee or grantor, as applicable, by certified mail, return receipt requested, to rescind or reform the general conveyance provision.

   (b) (1) Any grantee or grantor who refuses or neglects to correct or reform such legal description in the office of the register of deeds within 30 days after written demand has been made as provided in subsection (a), unless a longer period has been agreed to in writing by the parties, shall be liable in damages to the party for whom the demand was made in the sum equal to the greater of: (A) An amount up to $10,000 per title affected, or (B) an amount equal to the fair market value of the mineral or royalty interests actually conveyed by such general conveyance clause and not specifically described in the instrument, and reasonable attorney's fee for preparing and prosecuting the action before any court of competent jurisdiction. The plaintiff in such action may recover any additional damages that the evidence in the case warrants.

   (2) If such legal description has not been corrected or reformed within the time period allowed under paragraph (1), the court shall expedite an action

brought by any party pursuant to K.S.A. 60-1002, and amendments thereto, to quiet title. Such court ruling shall not relieve the grantee or grantor, as applicable, from any damages allowed under paragraph (1) nor relieve the grantee or grantor from any responsibilities under the provisions of this section.

(c) The remedies provided under this section shall not affect other remedies or damages provided by statute or law.

(d) A suit must be filed under this section within two years after the date the party making demand has actual knowledge of the improper legal description or conveyance.

(e) As used in this section:

(1) "Mother hubbard clause" means a provision in a deed or other instrument in writing which is intended to convey an interest in real estate and which describes the property to be conveyed as ***all of the grantor's property in a certain county***;

(2) "general conveyance provision" means a provision in a deed or other instrument describing an interest in real estate which, in addition to referring to the real estate specifically described in such deed or other instrument, ***describes unspecified other mineral or royalty rights or interests of the grantor in an entire township, county or state***; and

(3) "deed or conveyance covering mineral or royalty rights" means any deed or conveyance covering the grantor's mineral rights or the grantor's royalty rights.

7. **Shell Lease Form ¶ 1**: "In addition to said land, Lessor hereby grants leases and lets exclusively unto Lessee to the same extent as if specifically described herein ***all lands owned by or claimed by Lessor which are adjacent, contiguous to or form a part of said land***, including all oil, gas and all substances produced in association therewith underlying all alleys, streets, roads, highways, lakes, rivers, streams, or other bodies of water, easements and right of way which traverse ***or adjoin any of said land***."

This is not subject to the terms of 58-2273 for a number of reasons.

B. Recording Statutes: Listing for Taxation

1. **K.S.A. § 79-420. Surface and mineral rights taxed separately, when; duties of register of deeds, county clerk and county appraiser.** "Whenever the fee to the surface of any tract, parcel or lot of land is in any person or persons, natural or artificial, ***and the right or title to any minerals therein is in another or in others***, such mineral interest shall be listed and the market value, if any, determined separately from the fee of such land, in separate entries and descriptions. Such land and such mineral interest shall be separately taxed to the owners thereof respectively. ***In determining the market value, if any, of any such mineral interest, the appraiser shall consider every proper factor***, including but not limited to, the size of the particular mineral interest, the fractional share of such interest and the number of fractional shares in existence for such interest. The register of deeds shall furnish to the county clerk where such mineral interest exists and are a matter of record, a certified description of all such interest. ***When such reserves or leases are not recorded within 90 days after execution, they shall become void if not listed for taxation.***

2. Two ways to comply: record within 90 days after execution, or timely list for taxation (currently March 15, assuming K.S.A. § 79-306 is the appropriate "listing" reference).

3. Compliance with K.S.A. § 79-420 is a condition precedent to title vesting; failure to comply renders the grantee's title void and the interest remains with the grantor.

4. ***Becker v. Rolle***, 508 P.2d 509, 513 (Kan. 1973) (mineral deed executed 22 April 1929 and recorded 5 April 1930 was void and subject to attack by grantor's successors 40 years later).

5. **Handbook** at pp. 5-10 to 5-13.

C. Recording Statutes: Preserving Constructive Notice

1. Oil and gas leases cease to be constructive notice once the primary term has expired – unless an "affidavit of production" is filed for record in accordance with K.S.A. § 55-205.

2. **K.S.A. § 55-205. Record of lease as notice for definite term; extension upon contingency, affidavit.** "When an oil, gas or mineral lease is hereafter given on land situated within the state of Kansas, the recording thereof in the office of the register of deeds of the county in which the land is located ***shall***

impart notice to the public of the validity and continuance of said lease for the definite term therein expressed, but no longer: Provided,That, if such lease contains the statement of any contingency upon the happening of which the term of any such lease may be extended (such as "and as much longer as oil and gas or either are produced in paying quantities"), ***the owner of said lease may at any time before the expiration of the definite term of said lease file with the said register of deeds an affidavit setting forth the description of the lease, that the affiant is the owner thereof and the facts showing that the required contingency has happened.*** This affidavit shall be recorded in full by the register of deeds, and such record together with that of the lease ***shall be due notice to the public of the existence and continuing validity of said lease***, until the same shall be forfeited, canceled, set aside or surrendered according to law."

3. ***Cities Service Oil Company v. Adair***, 273 F.2d 673 (10th Cir. 1960).

   a. Cities was an assignee of a portion of a lease held by production from other portions of the lease operated by Sinclair. Sinclair obtained production within the primary term but filed an affidavit of production covering only its portion of the assigned lease.

   b. Over 25 years later the landowners leased Cities' portion of the leased land to Adair, who drilled three producing wells on the Cities leased land – which was held by production by Sinclair's production on its portion of the leased land.

   c. Held: Adair was a bona fide purchaser, the Sinclair affidavit of production only covered its portion of the lease, Cities lost its lease.

   d. "[I]n cases where the primary term of an entire lease has been extended due to production by a partial owner of the lease, the owners of other portions of the lease are required to file affidavits of production if they desire to protect their leaseholds as against innocent purchasers for value." *Id.* at 677.

4. **Handbook** at pp. 8-27 to 8-28.

D. Termination of Unused Pipeline Easements

1. **K.S.A. § 58-2271. Abandoned pipeline easements; release, failure to file, remedy.** "(a) For the purposes of this section, a pipeline easement shall be ***considered abandoned*** if the ***pipeline is removed from the easement without provision for replacing*** of the pipeline, or if ***no pipeline is placed in the***

easement within ten years after the easement is granted.

(b) If the grantee or assignee of record of a recorded pipeline easement abandons such easement, the grantee or assignee of record, within 20 days after requested by the owner of the property subject to the easement, shall file a release of the easement with the register of deeds of the counties in which the property is located.

(c) If a grantee or assignee of record of a pipeline easement refuses or neglects to file a release when required by subsection (b), the owner of the property may bring an action in a court of competent jurisdiction to recover from the grantee or assignee of record damages in the amount of $500, together with costs and reasonable attorney fees for preparing and prosecuting the action. The owner may recover such additional damages as the evidence warrants.

(d) As used in this section, "pipeline" means ***any pipeline designed to deliver an energy product other than for sale at retail.***"

2. Would this apply to a "blanket" easement created by an oil and gas lease? Would it mean that any unused areas for pipeline placement are lost after 10 years (excluding areas where pipelines already exist)? The easements associated with an oil and gas lease are much more than just a pipeline easement.

3. **Shell Lease Form ¶ 1**: "laying pipe lines"; **¶ 18**: "subsurface right-of-way"; **¶ 20**: "transporting of products."

E. Obligation to Release Terminated Oil & Gas Leases

1. **K.S.A. § 55-201. Duty of lessee to have forfeited lease released; publication notice; affidavit to be recorded; notice to landowner; remedies.** When any oil, gas or other mineral lease heretofore or hereafter given on land situated in any county of Kansas and recorded therein shall become forfeited it shall be the duty of the lessee, his or her successors or assigns, within sixty days from the date of the taking effect of this act, if the forfeiture occurred prior thereto, and within sixty days after the date of the forfeiture of any other lease, to have such lease surrendered in writing, such surrender to be signed by the party making the same, acknowledged and placed on record in the county where the leased land is situated without cost to the owner thereof: Provided, That, if the said lessee, his or her successors or assigns, shall fail or neglect to execute and record such surrender within the time provided for, then the owner of said land may serve upon said lessee,

his or her successors or assigns, in person or by registered letter, at his or her last-known address, or by publication for three consecutive weeks in a newspaper of general circulation in the county where the land is situated, a notice in writing in substantially the following form:

"To _____: I, the undersigned, owner of the following described land situated in _____ county, Kansas, to wit: (description of land) upon which a lease, dated _____ day of _____, 19__, was given to _____, do hereby notify you that the terms of said lease have been broken by the owner thereof, that I hereby elect to declare and do declare the said lease forfeited and void and that, unless you do, within twenty days from this date, notify the register of deeds of said county as provided by law that said lease has not been forfeited, I will file with the said register of deeds affidavit of forfeiture as provided by law; and I hereby demand that you execute or have executed a proper surrender of said lease and that you put the same of record in the office of the register of deeds of said county within twenty days from this date.

"Dated this _____ day of _____, 19__.

_____."

And the owner of said land may after twenty days from the date of service, registration or first publication of said notice, file with the register of deeds of the county where said land is situated an affidavit setting forth, that the affiant is the owner of said land; that the lessee, or his or her successors or assigns has failed and neglected to comply with the terms of said lease, reciting the facts constituting such failure; that the same has been forfeited and is void; and setting out in said affidavit a copy of the notice served, as above provided and the manner and time of the service thereof. If the lessee, his or her successors or assigns, shall within thirty days after the filing of such affidavit, give notice in writing to the register of deeds of the county where said land is located that said lease has not been forfeited and that said lessee, his or her successors or assigns, still claim that said lease is in full force and effect, then the said affidavit shall not be recorded but the register of deeds shall notify the owner of the land of the action of the lessee, his or her successors or assigns, and the owner of the land shall be entitled to the remedies now provided by law for the cancellation of such disputed lease. If the lessee, his or her successor or assigns, shall not notify the register of deeds, as above provided, then the register of deeds shall record said affidavit, and thereafter the record of the said lease shall not be notice to the public of the existence of said lease or of any interest therein or rights thereunder, and said record shall not be received in evidence in any court of

the state on behalf of the lessee, his or her successors or assigns, against the lessor, his or her successors or assigns.

2. **K.S.A. § 55-202. Same; action to obtain release; damages, costs and attorney's fees; attachment.** Should the owner of such lease neglect or refuse to execute a release as provided by this act, then the owner of the leased premises may sue in any court of competent jurisdiction to obtain such release, and the owner may also recover in such action of the lessee, his or her successors or assigns, the sum of one hundred dollars as damages, and all costs, together with a reasonable attorney's fee for preparing and prosecuting the suit, and he or she may also recover any additional damages that the evidence in the case will warrant. In all such actions, writs of attachment may issue as in other cases.

3. **K.S.A. § 55-206. Demand for release before bringing action; evidence.** At least twenty days before bringing the action provided for in this act[*], the owner of the leased land, either by himself or herself or by his or her agent or attorney, shall demand of the holder of the lease (if such demand by ordinary diligence can be made in this state) that said lease be released of record. Such demand may be either written or oral. When written, a letter-press or carbon or written copy thereof, when shown to be such, may be used as evidence in any court with the same force and effect as the original.

F. Mineral Lapse Act

1. **K.S.A. §§ 55-1601 to 55-1607.**

2. Many states have statutes, known as "dormant" mineral acts or mineral "lapse" statutes, designed to either reunite severed mineral estates with the "surface" estate or to identify owners of severed mineral estates.

3. The Kansas mineral lapse act is intended to identify severed mineral interest owners and provide them with an opportunity to maintain their severed mineral interest even when the interest has not been "used" during the statutory period.

4. ***Scully v. Overall***, 840 P.2d 1211 (Kan. Ct. App. 1992) (owner of severed mineral interest avoided having it "extinguished" by filing statement of claim within 60-day time period following surface owner's notice the interest had "lapsed" for nonuse).

5. The Kansas statutes, like those of other states, apply only when the severed mineral interest has not been "used" for a stated statutory period.

a. The statutory period in Kansas is 20 years.

b. **K.S.A. § 55-1603(a)** lists the statutory uses with a generic provision at §(b) providing for "[a]ny use pursuant to or authorized by the instrument creating the mineral interest . . . ."

c. For example, if the mineral owner entered the land on May 1, 1995 with the goal of staking the land to drill a well, even though they never drill a well, and the land contains no evidence of any development, the mineral owner's entry onto the land would be "pursuant to . . . the instrument creating the mineral interest" and that act alone would seem to extend the mineral interest by "use" until May 1, 2015.

d. If the interest has in fact been "used," the procedures to declare an interest lapsed and extinguished cannot apply.

e. The statutes apply only to a severed mineral interest "*if unused* for a period of 20 years . . . ." **K.S.A. § 55-1602.**

6. Even if the lapse procedures are followed, and the mineral interest "extinguished," there remains the risk that the mineral owner may come forward at some later date with facts to establish the interest was, in fact, used.

a. The only way to foreclose that possibility would be through a quiet title action.

b. The quiet title action requires all owners of the property to come forward and make their claim or have their rights forever barred. *See generally* **K.S.A. § 60-1002 (a)** ("An action may be brought by any person claiming title or interest in personal or real property, including oil and gas leases, mineral or royalty interests, against any person who claims an estate or interest therein adverse to him or her, for the purpose of determining such adverse claim."); ***Wheeler v. Ballard***, 137 P. 789, 791 (Kan. 1914).

7. **Statutory Uses: K.S.A. § 55-1603. Same; use of mineral interest defined.** (a) A mineral interest shall be considered to be used when:

(1) There are ***any minerals produced*** under the interest;

(2) operations are being conducted on the interest for ***injection, withdrawal,***

storage or disposal of water, gas or other fluid substances;

(3) ***rentals or royalties are being paid by the owner of the interest*** for the purpose of delaying or enjoying the use or exercise of the mineral rights;

(4) the ***use or exercise*** of the mineral rights is being carried out on a tract with which the mineral interest may be ***unitized or pooled*** for production purposes;

(5) in the case of coal or other solid minerals, there is production from a common vein or seam by the owners of the mineral interests; or

(6) ***taxes are paid on the mineral interest by its owner.***

(b) ***Any use pursuant to or authorized by the instrument creating the mineral interest*** shall be effective to continue in force all rights granted by the instrument.

8. **Simple filing procedure to avoid lapse: K.S.A. § 55-1604. Same; statement of claim, contents; filing, when and where; effect of failure to file.** "(a) ***A statement of claim may be filed by the owner of a mineral interest prior to the end of the twenty-year period specified by K.S.A. 55-1602*** or within three years after the effective date of this act, whichever is later. The statement shall ***contain the name and address of the owner of the mineral interest and a description of the land on or under which the mineral interest is located.*** The statement of claim shall be filed in the office of the register of deeds of the county in which the land is located. Upon the filing of the statement of claim within the time provided, ***it shall be considered that the mineral interest was being used on the date the statement of claim was filed.***

(b) Failure to file a statement of claim within the time prescribed by subsection (a) shall not cause a mineral interest to be extinguished if the owner of the mineral interest filed the statement of claim within 60 days after (1) publication of notice as prescribed by K.S.A. 55-1605, if such notice is published or (2) within 60 days after receiving actual knowledge that the mineral interest had lapsed, if such notice is not published."

VIII. OIL & GAS CONVEYANCING ISSUES

A. Defeasible Term Mineral Interests

1. ***O*** conveys to ***A*** 50% of the oil, gas, and other minerals in § 30 for 10 years and so long as oil or gas is produced.

    a. Assuming ***A***'s interest has not terminated, a developer will want to obtain a lease from ***A***, and from ***O,*** as the owner of the possibility of reverter.

    b. The basic issue: ***what can A rely upon to extend the duration of its mineral interest?***

        (1) Must have actual production of oil or gas to extend the duration of the grant into the secondary term. ***Dewell v. Federal Land Bank***, 380 P.2d 379, 383 (Kan. 1963) (payment of shut-in royalty under lease did not relieve defeasible term mineral interest owner of production requirement to maintain their interest).

        (2) Production must be in "paying quantities." ***Texaco, Inc. v. Fox***, 618 P.2d 844, 847 (Kan. 1980).

        (3) Typically the conveyance does not contain any sort of commencement, dry hole, completion, or shut-in royalty provisions. Nor is there an express incorporation of these terms under whatever oil and gas lease might be granted by a mineral owner.

        (4) Courts will apply the temporary cessation doctrine. ***Wilson v. Holm***, 188 P.2d 899, 905-06 (Kan. 1948).

2. Kansas courts have adopted special rules regarding the production requirement when a defeasible term mineral interest is pooled with other lands. The basic issue: ***will production from a pooled or unitized area maintain the defeasible term mineral interest when there is no well physically on the defeasible term mineral interest acreage?***

    a. ***Smith v. Home Royalty Ass'n, Inc.***, 498 P.2d 98 (Kan. 1972) (well must be physically on the acreage, no provision for pooling in the deed).

b. ***Classen v. Federal Land Bank***, 617 P.2d 1255 (Kan. 1980) (overrule Smith as to acreage that actually shares in pooled production, non-sharing acreage is not perpetuated).

c. ***Kneller v. Federal Land Bank***, 799 P.2d 485 (Kan. 1990) (refuse to give Classen retroactive effect to conveyances between the time *Smith* was decided (1972) and *Classen* (1980).

d. What was the rule pre-*Smith* (1972)? The "right" rule (*Classen*) or the "wrong" rule (*Smith*)? ***My view on the subject: Smith always was the "right" rule and it should never have been changed.***

e. Getting it wrong, yet again: ***Edmonston v. Home Stake Oil & Gas Corp.***, 762 P.2d 176 (Kan. 1988). Court ignores the express language of the Kansas Compulsory Unitization Act to hold that only the portion of the acreage that actually shares in unitized production is perpetuated). The Kansas unitization statutes make it clear, I thought, that production anywhere in the unit would be deemed to be from every tract within the unit – for all purposes.

B. Rule Against Perpetuities (Mineral/Royalty & K.S.A. § 79-420)

1. ***Rucker v. DeLay***, 235 P.3d 566 (Kan. Ct. App. 2010), review pending before Kansas Supreme Court.

   In 1924 land was conveyed with the following reservation in the grantor:

   "***The grantor herein reserves 60% of the land owner's one-eighth interest to the oil, gas or other minerals that may hereafter be developed under any oil and gas lease made by the grantee or by his subsequent grantees.***"

2. The grantees' successors, Rucker, asserted this created a reservation of a perpetual nonparticipating royalty interest which violates the rule against perpetuities and is therefore void.

3. The grantors' successors, DeLay, asserted this created a reservation of a mineral interest, which vested immediately, and even if it is a royalty interest it was excepted from the grant by the grantors and not subject to the rule.

4. In a thoughtful and thorough opinion, Justice Larson, assigned to the court of appeals panel, works through the extensive body of case law on distinguishing a "mineral" interest from a "royalty" interest.

a. Focusing on language indicating a right was created in the minerals when "developed," the court concludes, as did the trial court, a royalty interest was reserved.

(1) I think you could make good arguments that this is a "mineral" interest.

(2) If it were a mineral interest, the plaintiff argued it had not been filed for record, or listed for taxation, as required by K.S.A. § 79-420 and was therefore void.

b. As a "royalty" interest, it necessitated analysis of the perpetuities issue -- which again involved analysis of an extensive body of case law unique to Kansas.

5. The court holds the interest, as a perpetual "royalty" interest, violated the rule against perpetuities.

6. Regarding the reservation in the grantor, the court acknowledges the conceptual problem associated with the Kansas Supreme Court's holding that the vesting event for a royalty interest is upon production.

a. Interests retained by a grantor are typically viewed as being vested, because the grantor never parts with the excepted interest – if it was vested before the conveyance, and they never part with the interest, then it must be vested after the conveyance.

b. However, in Kansas since the vesting event is production, such an interest is never vested, in the grantor or anyone else, until and unless, there is production.

7. Justice Larson dutifully notes that the court of appeals is constrained by Kansas precedent, but invites counsel to seek review of the court's holding by the folks that can revisit the Kansas rule:

"We encourage the DeLays to seek review of our decision and our Supreme Court to accept, review, and determine whether the language found in *Sidwell*, *Drach*, and *Singer* indicates a change in the application of the rule against perpetuities to royalty interests. Such a review could also include an examination of the issue of whether production is to continue to be the vesting event if the rule against perpetuities is to continue to be applied to these transactions."

8. **COMMENT:** Although the Kansas Uniform Statutory Rule Against Perpetuities generally applies prospectively to transactions occurring after July 1, 1992 (K.S.A. § 59-3405), there is an important exception found at §(b) of 59-3405 which states:

"If a nonvested property interest . . . was created before the effective date of this act and is ***determined in a judicial proceeding***, commenced on or after the effective date of this act, ***to violate this state's rule against perpetuities*** as that rule existed before the effective date fo this act, a ***court upon the petition of an interested person may reform the disposition in the manner that most closely approximates the transferor's manifested plan of distribution and is within the limits of the rule*** against perpetuities applicable when the nonvested property interest or power of appointment was created."

a. Now that the DeLay's interest has been "determined in a judicial proceeding" to violate the Kansas common law rule against perpetuities, the DeLay's, by K.S.A. § 59-3405, are authorized to raise their void interest from the dead through reformation.

b. Reformation would work like this:

(1) the obvious intent of the grantor was to retain a perpetual interest;

(2) since a perpetual interest violates the rule, lets come up with a limitation the court can impose that will satisfy the rule;

(3) easiest way: identify a group of people living on May 17, 1924 (the date of the conveyance) and use the group as measuring lives to try and bring you within 21 years of the date of production (the vesting event).

c. I filed an *amicus curiae* brief in this case, and offered the following approach to reformation:

"Reformation would be a simple matter of selecting a few high profile individuals living on May 17, 1924 that can be used as measuring lives followed by 21 years. For example, the conveyance could be reformed so that its duration would run for a period of 21 years following the last to die of Prince Phillip, the Duke of Edinburgh, husband to Queen Elizabeth II (born 10 June 1921), and actor Mickey Rooney, formerly known as Joe Yule, Jr. (born

September 23, 1920). The duration could be extended even further by allowing it to continue beyond the "lives in being plus 21 years" period by adding a defeasible element: and "so long as" oil or gas is produced from the conveyed land."

d. This is clearly what the statute contemplates – and gives the Kansas Uniform Statutory Rule Against Perpetuities significant retroactive effect. The USRAP was not mentioned during the litigation – other than in my *amicus* brief. Nor was it mentioned by anyone during oral argument.

e. Rucker will want to defend this attempt by arguing the Statutory Rule was the product of a bill with multiple subjects and therefore violates the Kansas Constitution – and is void – and therefore we are back to the common law rule without the reformation remedy! I wrote an article about this issue: David E. Pierce, *Void Enactments of the Kansas Legislature*, 80 J. KAN. B. ASS'N 28 (July/Aug. 2011). My position is that USRAP is void. The Kansas Court of Appeals has held otherwise: ***Larson Operating Co. v. Petroleum Inc.***, 84 P.3d 626, 633-34 (2004).

C. *Duhig* in Kansas?

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

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

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

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

2. Kansas has one case that addresses *Duhig*. Unreported case that cannot be found using WestLaw but is available on the LexisNexis database: ***Grabs v. Dickson***, Case No. 58,991, 1986 Kan. App. LEXIS 1521 and Case No.

58,992, 1986 Kan. App. LEXIS 1524 (Kan. Ct. App. Nov. 13, 1986).

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

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

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

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

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

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

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

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

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

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

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

f. The court adopted *Duhig* noting:

> "Apparently the *Duhig* rule has never been considered in Kansas. The rule appears logical, however, and provides a method of construing all such deed[s] consistently. An old Kansas case provides some support for applying the rule here. In *Batterton v. Smith, 3 Kan. App. 419, 421, 43 Pac. 275 (1896)*, the court held a grantee's knowledge of title defects did not prevent his recovery from his grantor for breach of warranty based on the title defects."
>
> "Dickson warranted he was conveying all the mineral but reserved 1/16. Based on our conclusion that he owned on[ly] 1/3, he, therefore, breached his warranty to convey 15/16 of the minerals and should now be estopped to assert any claim that he reserved any interest. Unlike *Duhig*, furthermore, even this resolution does not prevent his breach of warranty–he still failed to transfer (15/16 - 1/3) or 29/48 to Grabs."

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

D. Oil & Gas Mathematics: 1/16th = 8/16ths

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

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

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

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

> "'As the most common leasing arrangement provides for a one-eighth royalty reserved to the lessor, ***the confusion of fractional interests stems primarily from the mistaken premise that all the lessor-landowner owns is a one-eighth royalty*** [when their mineral interest has been leased]. In conveying minerals subject to an existing lease and also assigning a corresponding

fractional interest in the royalties received, mistake is often made in the fraction of the minerals conveyed by multiplying the intended fraction by one-eighth. Thus, if a conveyance of an undivided one-half of the minerals is intended, the parties will multiply one-half by one-eighth and the instrument will erroneously specify a conveyance of one-sixteenth of the minerals on the assumption that one-sixteenth is one-half of what the grantor owns."

5. The court in *Heyen* declared the conveyance "ambiguous."

6. Think about the problems the Texas Supreme Court has had with this issue and the "three-blank" deed form: conveyed interest, present lease rights, future lease rights. ***Concord Oil Co. v. Pennzoil Exploration and Prod. Co.***, 966 S.W.2d 451 (Tex. 1998) (1/96th in the granting clause; 1/12th of the lease benefits under the present lease clause; court held it conveyed a 1/12th mineral interest).

   a. Court rejects two grants theory and applies a four-corners, harmonization approach.

   b. David E. Pierce, *Developments in Nonregulatory Oil & Gas Law: The Continuing Search for Analytical Foundations*, 47 INST. ON OIL & GAS L. & TAX'N 1-1, 1-22 to 1-26 (1996).

   c. David E. Pierce, *Interpreting Oil and Gas Instruments*, 1 TEXAS J. OF OIL, GAS AND ENERGY L. 1 (2006).

E. Nonapportionment Doctrine

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

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

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

   b. How will royalty under the lease be divided?

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

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

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

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

4. **Shell Lease Form, ¶ 10.** "If the leased premises ***are now or shall hereafter be owned in severalty or in separate tracts***, the premises may nonetheless be developed and operated as one lease, and ***all royalties accruing hereunder shall be divided among and paid to such separate owners in the proportion that the acreage owned by each separate owner bears to the entire leased acreage***. There shall be no obligations on the part of the Lessee to offset wells on separate tracts into which the land covered by the lease may now or hereafter be divided by sale, devisee [sic], descent or otherwise, or to furnish separate measuring or receiving tanks."

a. This "now" language can cause problems, particularly when different leases are joined in a pooled unit.

b. See ***Thomas Gilcrease Foundation v. Stanolind Oil & Gas Co.***, 268 S.W.2d 850 (Tex. 1954).

F. Saltwater Disposal Rights

1. ***Colburn v. Parker and Parsley Development Co.***, 842 P.2d 321 (Kan. Ct. App. 1992).

a. Who has the authority to unilaterally grant saltwater disposal rights when property is subject to an oil and gas lease granted by the landowner? Landowner? Oil and Gas Lessee? Need both to agree?

b. Lease silent regarding lessee's right to use the land to dispose of on-lease water. Court held the lessee's right is implied:

"[T]he [lessee's] right to dispose of salt water is created by implication and by statutory law. This right arises by the reasonable application of implied covenants to oil and gas leases, which have long been recognized by our Kansas courts." *Id.* at 325-26.

"***We hold the granting clause in an oil and gas lease includes an implied covenant to dispose of the salt water produced during operations by utilizing a saltwater disposal well drilled on the leased premises without additional compensation to the lessor.***

We hold that such a right is required in order for the production of oil and gas to be accomplished." *Id.* at 327.

c. Here the lessee had contracted away its right to use the well, free of charge, for disposal of on-lease water when it agreed to pay for disposal of all water, including off-lease water, under a separate salt water disposal agreement.

2. ***Crawford v. Hrabe***, 44 P.3d 442 (Kan. 2002) (Justice Larson again, but this time writing for the Kansas Supreme Court).

a. I think this is one of the most important cases for producers in Kansas, as to operational matters.

b. Can lessee use off-lease salt water to inject into leased land to conduct a waterflood (and charge third parties to dispose of their water in the process of injecting it for secondary recovery operations)? Yes. Legitimate operations to maximize production from the leased land, the fact the lessee makes some money from water disposal (that is not shared with the lessor) is good business.

c. "[I]t can be argued that if a surface owner does not have an action in trespass for removal of salt water so long as it is done for the purpose of increasing the lessor's production, then neither would a cause of action for trespass lie where off-lease water is injected for the purpose of increasing production."

d. If you can make out a sound operational basis for the activity, which aids in the economical recovery of oil and gas from the land, then it may be permissible conduct – even though it might otherwise be a trespass under other circumstances.

3. ***Dick Properties, LLC v. Paul H. Bowman Trust***, 221 P.3d 618 (Kan. Ct. App. 2010). In 2005 Dick Properties conveyed land to Leland Schonthaler, but excepted all: "[e]asements, rights of way, mineral reservations, oil and gas leases, and restrictions of record."

a. From this the court of appeals concludes that Schonthaler owned the land and "Dick Properties owns all mineral interests in the land."

b. Dick Properties therefore retained the benefits as the lessor under a 1988 oil and gas lease with the current working interest owner of the oil and gas lease: Paul Bowman Oil Trust ("Bowman").

c. Bowman sought to renew a saltwater disposal agreement that would allow it to dispose of salt water from the leased land and from other lands.

d. The issue: who must Bowman contract with for saltwater disposal rights that extend beyond those encompassed by its rights as an oil and gas lessee?

(1) The surface owner only (Schonthaler)? The mineral owner only (Dick Properties)? Both the surface owner and mineral owner?

(2) The parties stipulated that the disposal of water under the disposal agreement did not impact the oil and gas rights of Dick Properties.

e. Held: The surface owner, Schonthaler, owns the rights to dispose of things on the property that do not impact oil and gas operations – therefore Bowman need not contract with the mineral owner (Dick Properties).

f. Analysis: "We do not think Dick Properties retains sufficient interest in this real estate that would require it to be a party to a saltwater disposal lease. . . . In our view, what Dick Properties reserved was simply the mineral interests to the real estate."

g. Court examines the mineral interest retained by Dick Properties as though it was merely the rights to oil and gas.

(1) Would the outcome be different if indeed Dick Properties owned "all" the minerals in the land – not just the oil and gas?

(2) Court concludes Dick Properties lacked the ability to use its mineral interest to authorize the disposal of salt water produced off premises.

h. Conclusion: "Therefore, we hold Dick Properties transferred the rights to the saltwater disposal agreement to Schonthaler by execution of the deed."

i. My analysis:

(1) It is obvious the court focused on the wrong language. This

deed was not part of the court's opinion; I obtained a copy from counsel when I could not figure out the language the court was using to do its analysis.

(2) Schonthaler was conveyed: "SURFACE RIGHTS ONLY"

(3) The language the court focuses on, as the excepted mineral interest, was instead an exception ***to the warranty*** clause of the deed.

(4) This means Dick Properties owned "all" the minerals – except perhaps those associated with the surface itself.

(5) Who owns the subterranean rock structure where the salt water is being injected?

(6) Who owns the subterranean rock structures one has to pass through to get to the rock structure and space where the salt water is being injected?

(7) Will Kansas apply the same sort of "all minerals" analysis to a "SURFACE RIGHTS ONLY" grant that it does to a mineral grant? *E.g.*, surface destruction test, community knowledge test.

(8) Does a "SURFACE RIGHTS ONLY" grant to a grantor give that grantor less rights in "minerals" than would be the case if they owned the fee and conveyed "all minerals" to a grantee?

j. This issue will probably be resolved by defining the concurrent easement rights of a mineral owner and the "surface" owner.

4. **Restatement (Third) of Property: Servitudes § 4.12 Rights of Holders of Separate Servitudes in Same Property**

"Unless the terms of the servitudes determined under § 4.1 provide otherwise, holders of separate servitudes creating rights to use the same property must exercise their rights so that they do not unreasonably interfere with each other. In the event of irreconcilable conflicts in use, priority of use rights is determined by priority in time, except as a later-created servitude takes free of another under the applicable recording act."

5. **Easement by Necessity Analysis: Restatement (Third) of Property: Servitudes**

a. **§ 2.11 Servitudes Created by Implication**

"(a) The creation of a servitude burden may be implied by the circumstances surrounding the conveyance of another interest in land, as provided in §§ 2.12 through 2.15."

b. **§ 2.15 Servitudes Created by Necessity**

"A conveyance that would otherwise deprive the land conveyed to the grantee, or land retained by the grantor, of rights necessary to reasonable enjoyment of the land implies the creation of a servitude granting or reserving such rights, unless the language or circumstances of the conveyance clearly indicate that the parties intended to deprive the property of those rights."

c. **Comment a.** Rationales for recognizing an easement by necessity: presumed intent of the parties and public policy favoring productive use of land.

d. **Comment b.** addresses access rights as they relate to a horizontal severance of land, stating:

"A conveyance dividing property into horizontal estates will include implied servitudes for access from the surface estate to the estates above and below the ground. A conveyance of a profit will include a right of access to the subject of the profit. A conveyance of an easement will include a right of access to the easement. The implied rights necessary to enjoy profits and easements are often called secondary easements."

"Rights necessary to the enjoyment of property may include rights in addition to access, particularly when the property is severed into horizontal estates, or when nonpossessory interests are created. Support rights are necessary to the enjoyment of all horizontal estates that lie above other horizontal estates. To enjoy a profit, the owner must ordinarily be able to extract and remove the subject of the profit; to enjoy an easement, the owner must often be able to improve and maintain the easement way. Although customary usage has often collapsed the rights necessary to enjoyment of a profit into the concept of the profit itself, the implied secondary rights necessary to

enjoyment of profits share a common origin with the implied easements by necessity that provide access to the surface possessory estates. For analytical purposes, implied rights necessary to reasonable enjoyment of profits are treated as implied servitudes covered by the rule stated in this section."

e. **Illustrations:** "The following Illustrations are based on the assumption that there is no indication in the language or circumstances of the conveyance that the parties intended to deprive the land of rights necessary to its enjoyment."

"4. O, the owner of Blackacre, conveys subsurface coal rights to A. Without access through the surface of Blackacre, A has no right to gain access to the coal. There is an implied servitude granting all rights necessary to mine the coal through O's retained surface estate."

"5. Same facts as in Illustration 4, except that the coal completely underlies Blackacre, so that without access through the coal, O has no right to reach water and oil that underlie the coal. There is an implied servitude reserving rights of access to underlying strata for the benefit of the surface owner."

"6. O, the owner of Blackacre, conveyed the standing timber on Blackacre to A. The conveyance did not include express rights to enter Blackacre or to cut and remove the timber. Conveyance of the timber includes an implied servitude for all rights necessary to cut and remove the timber."

"7. O, the owner of Blackacre, conveyed an easement for a pipeline to A. The conveyance did not include express rights to enter Blackacre to install or maintain the pipeline. Conveyance of the pipeline easement includes an implied servitude for all rights necessary to enjoy the pipeline easement, including rights to install and maintain the pipeline."

6. **Easements and Hydraulic Fracturing and Horizontal Drilling.**
§ 4.10 Use Rights Conferred by a Servitude

"Except as limited by the terms of the servitude determined under §4.1, the holder of an easement or profit as defined in §1.02 is entitled to use the servient estate in a manner that is reasonably necessary for the convenient enjoyment of the servitude. ***The manner, frequency, and intensity of the use may change over time to take advantage of developments in technology and***

to accommodate normal development of the dominant estate or enterprise benefited by the servitude. Unless authorized by the terms of the servitude, the holder is not entitled to cause unreasonable damage to the servient estate or interfere unreasonably with its enjoyment."

a. **Comment c.** "*Servitude holder is entitled to make any use reasonably necessary for convenient enjoyment.* The uses that are reasonably necessary for enjoyment of an easement change over time as technology changes and as use of the dominant and servient estates changes. As change takes place, conflicts often arise between the servitude owner and the owner of the servient estate. . . ."

"Under the rule stated in this section, the servitude holder is entitled to make any use of the servient estate that is reasonably necessary for the convenient enjoyment of the easement. . . . The right to use additional areas of the servient estate is sometimes called a 'secondary' easement. Conceptually, a secondary easement can be regarded either as an easement by necessity or as inherently included within the primary-use rights granted by the easement."

b. **Comment d.** "*Use within purpose of servitude.* The first step in determining whether the holder of an easement is entitled to make a particular use challenged by the owner of the servient estate is to determine whether the use falls within the purposes for which the servitude was created."

c. **Comment f.** "*Changes in manner, frequency, and intensity of use.* Under the rule stated in this section, the manner, frequency, and intensity of use of the servient estate may change to take advantage of developments in technology and to accommodate normal development of the dominant estate, or of the enterprise benefited by the servitude. Changes in use of the dominant estate, or enterprise benefited by an easement in gross, are irrelevant unless they also bring a change in the manner, frequency, or intensity of use of the easement. . . . The policy underlying the rule is that it permits servitudes to retain their utility over time and probably reflects the expectations of the parties who create servitudes of indefinite duration . . . ."

IX. OIL & GAS LEASING ISSUES

A. Duration of the Rights Granted: Habendum Clause

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

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

    b. What are "paying quantities"?

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

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

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

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

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

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

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

        (7) In Kansas the selection of the accounting period for comparing revenue and expenses is critical because, as the

court notes, the continuing life of the lease "is a straightforward profit and loss mathematical computation." *Id.* at *6.

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

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

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

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

2. **The Shell form at ¶ 2**: "This lease shall remain in force for a term of ____ from the date hereof, (called "primary term") and as long thereafter as oil, gas, casinghead gas, casinghead gasoline or any of the products covered by this lease is ***or can be*** produced."

a. In Kansas, "production" means actual production and marketing.

b. "[O]r can be" is intended to change this and provide for a "discovery" rule similar to that applied by Oklahoma courts.

c. ***Hunthauser Holdings, LLC v. Loesch***, Case No. Civ.A. 00-1154-MLB, 2003 WL 21981961 (D. Kan. June 10, 2003) (regarding lease on Kansas land, court gives effect to "or can be produced" language by holding the lease can be extended either by actual production or a "capability to produce"). Court follows Texas Supreme Court's ruling in ***Anadarko Petroleum Corp. v. Thompson***, 94 S.W.3d 550 (Tex. 2002).

B. Duration of the Rights Granted: Shut-In Royalty Clause

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

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

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

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

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

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

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

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

      (1) Cases where there is no pipeline connection.

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

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

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

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

(2) The court continued, noting:

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

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

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

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

2. **The Shell form at ¶ 4**: "During any period after expiration of the primary term hereof when gas is not being so sold or used and the well or wells are shut in and there is no current production of oil or operations on said leased premises sufficient to keep this lease in force, Lessee ***shall pay*** or tender a royalty of One Dollar ($1.00) per year per net acre retained hereunder, such payment or tender to be made, on or before the later of ninety (90) days following the date of shut in or the anniversary date of this lease during the period such well is shut in, to the Lessor. ***When such payment or tender is***

made it will be considered that gas is being produced within the meaning of the entire lease."

a. The "shall pay" is good – makes it a covenant.

b. But, the "When such payment" language makes payment the required event to have the well be considered production under the habendum clause. This sounds like a condition to having "production" under the habendum clause.

c. Is a shut-in clause necessary when you have meet the "can be produced" language of ¶ 2?

C. Duration of the Rights Granted: Operations-Related Clauses

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

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

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

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

(1) ***Hall v. JFW, Inc.***, 893 P.2d 837 (Kan. Ct. App. 1995), *rev. denied.* (lessee did everything you can do but have a rig turning the bit on the critical date).

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

(3) ***Bunnell Farms Co. v. Samuel Gray, Jr. & Associates***, 47 P.3d 804 (Kan. Ct. App. 2002) (commence drilling with rig to set surface casing).

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

drill into leased tract).

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

2. **The Shell form at ¶ 12**: "Whenever used in this lease the word ***'operations' shall refer to*** any of the following and any activities related thereto: ***preparing location for drilling***, drilling, testing, completing, equipping, reworking, re-completing, deepening, plugging back, repairing a well or the production of water in search for or in an endeavor to obtain production of oil and/or gas."

3. "If prior to the discovery of oil, liquid hydrocarbons, gas or their respective constituent products, or any of them, on said land or land pooled therewith lessee should ***drill and abandon a dry hole*** or holes thereon, or if, after discovery of oil, liquid hydrocarbons, gas or their respective constituent products, or any of them, the ***production thereof should cease from any cause***, this lease shall not terminate if lessee ***commences reworking or additional drilling operations*** within sixty (60) days thereafter, ***or*** **(if it be within the primary term)**, (i) ***in the case of a dry hole***, commences or resumes the payment or tender of rentals or commences operations for drilling or reworking on or before the rental paying date occurring twelve (12) months after the expiration of the rental period during which such dry hole was drilled, or (ii) ***in the case of cessation of production***, commences or resumes the payment or tender of rentals or commences operations for drilling or reworking on or before the rental paying date next ensuing after the expiration of three (3) months from the cessation of production. **[Dry Hole Clause; Cessation of Production Clause]**

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

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

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

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

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

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

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

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

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

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

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

g. Classic condition vs. covenant analysis.

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

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

produced in paying quantities.

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

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

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

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

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

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

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

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

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

(7) The court's interpretation, excluding any temporary cessation doctrine considerations, means the full universe of events that can interrupt production(event those not technically within the

scope of "reworking" or "additional drilling"), must somehow be accounted for.

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

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

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

b. What is the scope of "reworking"?

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

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

a. New York Marcellus moratorium.

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

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

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

in delivery of any product, labor, service, or material."

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

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

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

X. CONCLUSIONS

Kansas has a unique body of oil and gas law. The Kansas Supreme Court has, in recent years, been willing to accept a number of "oil and gas" cases. Currently pending before the court are cases dealing with the nonparticipating royalty and the rule against perpetuities, and various operational issues. Class action royalty litigation is ongoing and will probably continue until the court is able to reaffirm that "at the well" means "at the well."

Much of Kansas oil and gas law is the product of Kansas Court of Appeals decisions. Those decisions are always open for reexamination by the Kansas Supreme Court – such as, when is a well "commenced." I predict that new production in the state will trigger a reexamination of many title issues as third parties seek to gain an interest in proven production. Many of those issues will arise out of the issues we have discussed today. For example, will the Kansas Supreme Court adopt a *Duhig* analysis?

Thank-you for the opportunity to share this time with you discussing my favorite topic: "oil and gas" law.

David Pierce