

Michigan Law Review

Volume 53 | Issue 3

1955

The Rule Against Perpetuities and Typical Oil and Gas Leases

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Recommended Citation

David R. Macdonald S.Ed., *The Rule Against Perpetuities and Typical Oil and Gas Leases*, 53 MICH. L. REV. 462 (2021).

Available at: <https://repository.law.umich.edu/mlr/vol53/iss3/7>

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THE RULE AGAINST PERPETUITIES AND TYPICAL OIL AND GAS LEASES—Probably the most common transaction employed in the development of oil and gas deposits today is the fixed term, “thereafter” clause lease.¹ This lease provides for a conveyance of all interest in oil and gas in the land for a fixed term, e.g., five years, and so long thereafter as oil or gas is produced. Another lease, of diminishing importance, is the “no term” lease, in which there is no fixed term, but the lessee is allowed to keep the lease alive indefinitely, without drilling, by the payment of “delay rentals.” Recently, a lower California court voided part of a conveyance in fee simple of a tract of land which reserved a fixed term, “thereafter” clause oil and gas lease in the grantor as violative of the rule against perpetuities.² The court construed the lease as retaining a determinable fee in a profit a prendre in the grantor with an executory interest in the grantee to begin on the termination of drilling. Since this contingency was not certain to occur within the period of the rule, the executory interest was struck down. This comment is concerned with the examination of various methods of creating future interests in gas and oil and the effect of the rule against perpetuities on these interests. For the sake of clarity, these will be separated into two basic situations in which the interests arise. The possible invalidity of perpetual non-participating royalty interests or non-executive mineral rights, in which one person has the right to receive profits, rentals, or a percentage of the oil itself without having the right to develop or sublease the oil interest, will not be considered here.³

¹ Meyers, “The Effect of the Rule against Perpetuities on Perpetual Non-Participating Royalty and Kindred Interests,” 32 *TEX. L. REV.* 369 at 370 (1953-54).

² *Victory Oil Co. v. Hancock Oil Co.*, (Cal. App. 1954) 270 P. (2d) 604. Gray has succinctly stated the rule as follows: “No interest subject to a condition precedent is good, unless the condition must be fulfilled, if at all, within twenty-one years after some life in being at the creation of the interest.” *GRAY, RULE AGAINST PERPETUITIES*, 4th ed., §201, p. 191 (1942).

³ A California appellate court, in the case of *Dallapi v. Campbell*, 45 Cal. App. (2d) 541, 114 P. (2d) 646 (1941), held that a fee simple conveyance reserving the right to grant oil and gas leases was invalid as a power to create interests in land which could be exercised beyond the period of the rule. See 2 *SIMES, FUTURE INTERESTS* §536, p. 412 (1936). Kansas, on the other hand, has held that an agreement to assign rents and royalties from future oil leases is void since the assignee’s interest in the lease is not sure to vest within the period of the rule. *Miller v. Sooy*, 120 Kan. 81, 242 P. 140 (1926); *Lathrop*

I. *The Grantor Owns Only the Oil and Gas Rights to Blackacre*

Suppose that *A* owns the complete oil and gas rights to Blackacre in fee simple, but not the surface estate. The fact that this is almost universally considered a property interest today⁴ renders it subject to the rule against perpetuities.⁵ *A* then conveys a fixed term, "thereafter" clause lease to *B*. Under the law of most states, *B*'s estate is construed as a determinable fee simple, with a possibility of reverter in the grantor.⁶ At least one state considers it a lease with an option to renew, exercised by producing oil continuously from the expiration of the fixed term. The lessee becomes a tenant at will after the termination of the fixed term.⁷ In the example given, it does not matter which construction is accepted since neither a reversion nor a possibility of reverter is subject to the rule.⁸ On the other hand, should *A* grant to *B* the future interest in the oil and gas estate, saving the fixed term, "thereafter"

v. *Eyestone*, 170 Kan. 419, 227 P. (2d) 136 (1951). In other words, when the exclusive right to lease is separated from a property interest in the oil and gas, one court has voided the right and another has voided the property interest. There is not much authority for either view. On the subject generally, see Meyers, "The Effect of the Rule against Perpetuities on Perpetual Non-Participating Royalty and Kindred Interests," 32 TEX. L. REV. 369 (1953-54); Morris, "Some Legal Consequences Resulting from a Separation of the Incidents of Ownership of a Mineral Interest," 7 OKLA. L. REV. 285 (1954).

⁴ Some states consider it a horizontal corporeal estate in the oil and gas in place, analogizing it to other solid mineral estates. *Sammons v. Warfield Natural Gas Co.*, 304 Ky. 548, 201 S.W. (2d) 719 (1947). Other states reject this contention, arguing that oil moves from one tract to another underground, and is incapable of being owned. It is therefore in the nature of a profit. *Dabney-Johnston Oil Corp. v. Walden*, 4 Cal. (2d) 637, 52 P. (2d) 237 (1935). Cf. *Thomas v. Standard Development Co.*, 70 Mont. 156, 224 P. 870 (1924), where a lease which the lessee could terminate virtually at will was held to be an "option"; this did not necessarily negate it as a property interest, however.

⁵ 1A SUMMERS, OIL AND GAS, perm. ed., §134, p. 235 (1954).

⁶ *Bruner v. Hicks*, 230 Ill. 536, 82 N.E. 888 (1907); *Terry v. Humphreys*, 27 N.M. 564, 203 P. 539 (1922); *Dale v. Case*, 217 Miss. 298, 64 S. (2d) 344 (1953); *Rosson v. Bennett*, (Tex. Civ. App. 1927) 294 S.W. 660. California now follows this view. *Dabney v. Edwards*, 5 Cal. (2d) 1, 53 P. (2d) 962 (1935). It should be noted that the terms "lessee" and "lessor" are often used, although the interest created is not always considered a lease.

⁷ *State v. South Penn Oil Co.*, 42 W.Va. 80 at 102, 24 S.E. 688 (1896). See also *Aikens v. Nevada Placer, Inc.*, 54 Nev. 281, 13 P. (2d) 1103 (1932). But cf. *Wilson v. Reserve Gas Co.*, 78 W.Va. 329, 88 S.E. 1075 (1916). California at one time indicated approval of this doctrine in *Graciosa Oil Co. v. Santa Barbara County*, 155 Cal. 140, 99 P. 483 (1909), but expressly rejected it in *Dabney v. Edwards*, 5 Cal. (2d) 1, 53 P. (2d) 962 (1935). In the latter case, the court argued that a tenancy at will was not possible when the lessor did not also have the option to terminate. This position has the support of the author of the applicable part of the AMERICAN LAW OF PROPERTY, as constituting the "modern view," although its author admits that there is authority for the view that a tenancy at will may exist where the lease is at the will of the lessee only. 1 AMERICAN LAW OF PROPERTY §3.30, p. 232 (1952). It might also be noted that at common law, an estate at will is terminated on the death of either party; such a termination is not intended in fixed term, "thereafter" clause leases. See 1 AMERICAN LAW OF PROPERTY §3.91, pp. 377-378 (1952).

⁸ *Fletcher v. Ferrill*, 216 Ark. 583, 227 S.W. (2d) 448 (1950).

clause lease, the difference becomes crucial. The majority rule would cause *B*'s estate to be a springing executory interest, void because not certain to vest within the period of the rule.⁹ Courts construing it as a lease with option to renew, however, would be spared the necessity of striking down *B*'s interest, since an option to renew a lease, even if perpetual, does not contravene the rule.¹⁰ Parallel questions arise with the "no term" lease. This has also been characterized as a determinable fee interest,¹¹ although it usually is construed as a perpetual renewal lease by using the same rationale as with the fixed term, "thereafter" clause lease.¹² Although no case involving the rule has been found where the lease is *retained*, the "no term" lease has been held immune from the rule where it was *conveyed* by the grantor.¹³

II. *The Grantor Owns the Fee Simple in Blackacre*

In this situation, *A* has a fee simple estate in the surface as well as subsurface of Blackacre. Should he grant either of the aforementioned

⁹ This is the holding of the California court in *Victory Oil Co. v. Hancock Oil Co.*, (Cal. App. 1954) 270 P. (2d) 604. See also 2 SIMES, *FUTURE INTERESTS* §504, p. 363 (1936).

¹⁰ *Becker v. Submarine Oil Co.*, 55 Cal. App. 698, 204 P. 245 (1921); 2 SIMES, *FUTURE INTERESTS* §511, p. 375 (1936); GRAY, *RULE AGAINST PERPETUITIES*, 4th ed., §230, pp. 231-233 (1942); 3 A.L.R. 498 (1919). Gray cautions that where there is a substantial condition precedent to renewal, as is the case in oil and gas leases, this might void the lessee's power to renew. GRAY, *RULE AGAINST PERPETUITIES*, 4th ed., §230.1, pp. 232-233 (1942). The point of attack on the conveyance has been the lessee's option. Where the grantor retains the lease and not the reversion, however, the grantor-lessor's interest might also be attacked as an executory interest subject to the condition precedent of non-renewal and not certain to vest in the required time. The argument of Simes, cited above, that commercial use is promoted rather than hindered by the lease in question seems to refute theoretical considerations for voiding the lease regardless of who holds the future interest.

¹¹ *Stephens County v. Mid-Kansas Oil & Gas Co.*, 113 Tex. 160, 254 S.W. 290 (1923); *Watford Oil & Gas Co. v. Shipman*, 233 Ill. 9, 84 N.E. 53 (1908).

¹² See the cases cited in note 13 *infra*, and *Wilson v. Reserve Gas Co.*, 78 W.Va. 329, 88 S.E. 1075 (1916), where a "no term" lease is evidently construed as a leasehold interest. The tendency is to consider a delay rental more as an option to renew than as a determinable fee, probably because of the periodic nature of the payments.

¹³ *Becker v. Submarine Oil Co.*, 55 Cal. App. 698, 204 P. 245 (1921); *Todd v. Manufacturers' Light and Heat Co.*, 90 W.Va. 40, 110 S.E. 446 (1922); *Montana Consol. Mines Corp. v. O'Connell*, 107 Mont. 273, 85 P. (2d) 345 (1938). Occasionally there is executed a fixed term, "thereafter" clause lease which also provides for payment of delay rentals after the fixed term. Attacks on this type of lease for remoteness have been unsuccessful, although the nature of the lessee's interest is not agreed upon. In *Rosson v. Bennett*, (Tex. Civ. App. 1927) 294 S.W. 660, the lessee took a determinable fee. In *Lloyd's Estate v. Mullen Tractor & Equipment Co.*, 192 Miss. 62, 4 S. (2d) 282 (1941), however, the lessee held a lease with a perpetual option to renew as long as he paid delay rentals. Under the holding of *Dale v. Case*, 217 Miss. 298, 64 S. (2d) 344 (1953), this lease would turn into a determinable fee when drilling was started or oil was produced. This itself might raise questions under the rule similar to those arising in an option to purchase connected with a lease, not to speak of the difficulties involved if the grantor were the lessee instead of the lessor, as in *Victory Oil Co. v. Hancock Oil Co.*, (Cal. App. 1954) 270 P. (2d) 604.

types of oil and gas lease to *B*, all rights in the land would be upheld,¹⁴ as in the case where *A* makes a lease while owning only the oil and gas rights.¹⁵ If he conveys a "reversionary" oil and gas interest and reserves the surface fee plus the leasehold interest in the oil and gas, the grantee's interest would depend on the construction given to the two typical leases, as discussed above.¹⁶ If *A* conveys the fee to *B*, reserving an oil and gas lease, however, further refinements arise.¹⁷ In the first place, it has been argued that the retention of an oil and gas interest is construed as a reservation and not an exception, and therefore, because of the "regrant" theory, the mineral estate of the grantee is not a springing executory interest but a possibility of reverter.¹⁸ Under the English theory of "regrant," when a grantor retained an easement or other incorporeal interest from a granted corporeal estate, he was thought of as obtaining the easement through an act or regrant by the grantee.¹⁹ Thus the grantee was contemplated as the grantor of the easement. This concept, if carried to its logical conclusion, would confer upon the oil and gas interest in the present example the sanctity of a possibility of reverter. Without discussing the obstacles which have to be overcome before this proposition can even be considered,²⁰ the regrant theory cannot be accepted from either a practical or theoretical standpoint.²¹ Its application would validate the conveyance of *B*'s interest

¹⁴ The leases referred to from this point are the fixed term, "thereafter" clause, and "no term" types.

¹⁵ Under the English regrant theory, discussed below, the grantor's reversion in the oil and gas lease might be void.

¹⁶ An easement or profit which arises at a remote time is subject to the rule. 2 *SIMES, FUTURE INTERESTS* §509, pp. 372-373 (1936).

¹⁷ The discussion from this point presumes that the jurisdiction involved considers the fixed term, "thereafter" clause lease or the "no term" lease as giving rise to a determinable fee. Courts holding it a lease with option to renew avoid the rule completely as pointed out in Part I above.

¹⁸ *Victory Oil Co. v. Hancock Oil Co.*, (Cal. App. 1954) 270 P. (2d) 604 at 611-612.

¹⁹ 2 *AMERICAN LAW OF PROPERTY* §8.24, pp. 246-249 (1952). *Wickham v. Hawker*, 7 M. & W. 63, 151 Eng. Rep. 679 (1840). Dictum approving the regrant theory is often found. See *Aden v. City of Vallejo*, 139 Cal. 165, 72 P. 905 (1903); *Wagner v. Hanna*, 38 Cal. 111 at 116 (1869).

²⁰ States which construe oil and gas leases as being corporeal estates of oil and gas in place (note 4 supra) would of course consider the retention of the lease as an exception, not subject to the regrant theory. Even states which have held oil leases as incorporeal interests might construe the retained interest as an exception, since the intent of the parties is now considered as the determinative factor. See *Victory Oil Co. v. Hancock Oil Co.*, (Cal. App. 1954) 270 P. (2d) 604 at 611-612. Any incorporeal right retained from a corporeal grant was a reservation under the older view. 2 *AMERICAN LAW OF PROPERTY* §106, p. 517 (1952).

²¹ The regrant theory is criticized in 2 *AMERICAN LAW OF PROPERTY* §8.24, p. 248 (1952): "It does not seem that either the theory or the requirement of a 'regrant' was necessary. The theory might have been that the grantor was simply keeping some of the rights he already had. . . ." 5 *PROPERTY RESTATEMENT* §473, pp. 2968-2972 (1944), also exhibits disfavor of the theory.

in the present example, at the expense of voiding the same interest when it is reserved instead of conveyed. Furthermore, the regrant theory cannot be rationalized as easily in this country as in England, where both parties sign the deed.²² These considerations led the California court to look upon the theory as "fictional," insofar as its application to the rule was concerned.²³

Secondly, the future interest of *B*, the lessor, may be saved from the rule against perpetuities by means of a doctrine propounded by Professor Gray, who states that even if a right in land such as an easement could terminate at a remote time, the rule does not apply if it terminates by disappearing into the servient estate rather than by vesting in a third party.²⁴ Were this view accepted, however, *B*'s interest would be saved only by tying the future oil and gas interest to the surface fee ownership, a hindrance to commercial transactions which the rule was intended to prevent. As soon as *B* conveys the surface rights away, it would seem that his oil interest would lose the protection of Gray's theory and would become void. As a practical matter, therefore, the intricacies involved in this type of conveyance are not sufficiently clear to afford businessmen the certainty necessary to create oil and gas leases free from the threat of the rule against perpetuities.

III. Conclusion

As a general rule, it may be said that the conveyance of a leasehold oil and gas interest seems to be safe from attack because of the rule against perpetuities. On the other hand, where the "reversionary" interest is conveyed, whether concomitant with the surface estate or not, it is likely to be subjected to litigation, if not destruction. The obvious course in avoiding the problem is suggested by the English

²² See *Wickham v. Hawker*, 7 M. & W. 63, 151 Eng. Rep. 679 (1840).

²³ *Victory Oil Co. v. Hancock Oil Co.*, (Cal. App. 1954) 270 P. (2d) 604 at 611-612. The court did not decide the issue but referred to *Dallapi v. Campbell*, 45 Cal. App. (2d) 541, 114 P. (2d) 646 (1941) in support of its averment that a reservation could be found to violate the rule against perpetuities. In that case, however, it was the possible exercise of a reserved power beyond the period of the rule which voided the reservation.

²⁴ GRAY, *RULE AGAINST PERPETUITIES*, 4th ed., §278, pp. 307-312 (1942). For example: *A* conveys Blackacre to *B* in fee simple, reserving an easement of way so long as *A* shall maintain it. Upon the failure of *A* to maintain the easement, it becomes a part of *B*'s possessory estate. No interest is invalid. Gray's theory was followed in *Egner v. Livingston County Board of Education*, 313 Ky. 168, 230 S.W. (2d) 448 (1950). The California court did not consider this argument as a means of saving the grant in the *Victory Oil Co.* case, although California is committed to the view that an oil lease is an incorporeal profit. *Dabney-Johnston Oil Corp. v. Walden*, 4 Cal. (2d) 637, 52 P. (2d) 237 (1935). States which construe oil leases to be possessory estates of oil and gas in place cannot utilize this principle to save conveyances, since there would be no disappearance of an incorporeal right into a corporeal estate.

regrant theory. Whenever the grantor wishes to retain a lessee's interest in a standard oil and gas lease, he should first convey the fee in the oil and gas to the lessor-to-be, who should then convey back the oil lease. This simple expedient should avoid any possibility of invalidity under the rule against perpetuities, and should prevent embarrassment to conveyancers whose clients might otherwise "lose" oil and gas interests.

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