

1953

W. N. Preas v. Ray Phebus et al : Brief of Appellant

Utah Supreme Court

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Case No. 8104

IN THE SUPREME COURT
of the
STATE OF UTAH

W. N. PREAS,
Plaintiff and Appellant,

vs.

RAY PHEBUS, PAUL STOCK, JOE
T. JUHAN, WEBER OIL COM-
PANY, a Colorado Corporation,
EQUITY OIL COMPANY, a Utah
Corporation,

Defendants and Respondents.

FILED
DEC 23 1953
Clerk, Supreme Court, Utah

BRIEF OF APPELLANT

**SKEEN, THURMAN, WORSLEY,
& SNOW**

Attorneys for Appellant.

TABLE OF CONTENTS

	<i>Page</i>
STATEMENT OF FACTS	1
SATEMENT OF POINTS	15
ARGUMENT	
Point I. That the Trial Court erred in making and entering its conclusions of law, for the reason that the same are contrary to the evidence and stipulated facts, and against law	16
Point II. That the Trial Court erred in making and entering judgment in favor of Respondents and against Appellant, no cause of action, for the reason that said judgment is contrary to the evidence and stipulated facts and against law	16
Point III. That the Trial Court erred in making and entering its Findings of Fact, the same being contrary to the evidence and stipulated facts	50
Point IV. That the Trial Court erred in refusing Appellant's tender of proof that Appellant did not receive \$1.00, with reference to the execution of the agreement between Appellant and Phebus and Stock from which any right of Respondents must originate	52
CONCLUSION	53

INDEX OF AUTHORITIES

Arrington v. United Royalty, 65 SW (2d) 37	22
Bowes v. Republic Oil Co., 252 P. 800 (Mont.)	37
Callahan v. Martin, 43 P. (2d) 788	19-40
Clovis v. Carson Oil & Gas Co., 11 F. Sup. 797 (D.C.E.D., Mich.)	39
Ellison v. Skelly Oil Co., 244 P. (2d) 832 (Okla.)	41
Empire Gas & Fuel Company v. Saunders, 22 F. (2d) 733 (C.C.A. 5)	39
Gloyd v. Midwest Refining Co., 62 F. (2d) 483 (C.C.A. 10)	36
Guerra v. Chancellor, 103 S.W. (2d) 755 (Tex.)	39
Hill v. Stanolind Oil & Gas Co., 205 P. (2d) 643 (Colo.)	32

TABLE OF CONTENTS—(*Continued*)

	<i>Page</i>
Hudson v. Smith, 41 P. (2d) 861 (Okla.)	49
Lewis v. Grininger, 179 P. (2d) 463 (Okla.)	32
Luker v. Anderson, 10 S.W. (2d) 149	49
McCrabb v. Moulton, 124 F. (2d) 689 (C.C.A. 8)	39
McDaniel v. Hager-Stevenson Oil Co., 243 P. 582, 585 (Mont.)	39
Mark v. Bradford, 23 N.W. (2d) 205 (Mich.)	23-50
Marias River Syndicate v. Big West Oil Co., 38 P. (2d) 599 (Mont.)	23
Meagher v. Uintah Gas Company & Fuel Supply Company, 185 P. (2d) 747	10-14
Payne v. Callahan, 99 P. (2d) 1050	22
People's Gas Co. v. Dean, 193 F. 938 (C.C.A. 8, 1911)	25
Preas v. Phebus, 195 F. (2d) 61 (C.C.A. 10)	2
Rehard v. Klossner, 119 P. (2d) 145	45
Sheffield v. Hogg, 77 S.W. (2d) 1021, 1024, 80 S.W. (2d) 741	18
Sheldon v. Bright, 10 P. (2d) 831, (Kans.)	26
Skelly Oil Co. v. Wickham, 202 F. (2d) 442 (C.C.A. 10)	50
Stanolind Oil and Gas Co. v. Guertzgen, 100 F. (2d) 299 (C.C.A. 9)	31
Superior Oil Co. v. Jackson, 250 P. (2d) 23 (Okla.)	50
Tennant v. Dunn, 110 S.W. (2d) 53	17
Williams v. Ware, 31 P. (2d) 567 (Okla.)	39-42

TEXTS

90 A.L.R. 770	17
101 A.L.R. 884	17
131 A.L.R. 1371	17
12 C.J. 407	40
17 C.J.S. 475, Sec. 128	26
17 R.C.L. 715, paragraph 71	49
Summers Oil & Gas, Permanent Edition, Vol. 2, Sec. 452, page 494	34-35
Thompson on Real Property, Perm. Ed., Vol. 10, Sec. 5570	39

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Case No.
8104

BRIEF OF APPELLANT

STATEMENT OF FACTS

(All italics, unless otherwise noted, have been added
by Appellant).

Pleadings and Judicial Proceedings

This action was initially commenced by complaint
filed by appellant in the District Court of the Fourth
Judicial District on May 16, 1950 (R. 1). The case was
thereafter removed to the Federal District Court of the
District of Utah, the motion of appellant to remand
denied, and the case was tried before the Federal Court

without a jury on March 12, 1951. Thereafter appeal was taken to the United States Court of Appeals, Tenth Circuit, which court remanded the cause to the Utah District Court for further proceedings. *Preas v. Phebus*, 195 F. (2d) 61 (C.C.A. 10).

After the case was remanded to the State Court, the appellant filed an amended complaint (R. 12 to 28). The original complaint was in substance that of a typical quiet title action, and the amended complaint which formed the basis of the present trial (R. 12 to 28) retained the substance of the original complaint but broadened the issues to include other foundations of recovery. The complaint alleges that appellant W. N. Preas is the owner of a one-third of 1% oil royalty in and to 440 acres of land located on the Ashley Valley structure in Uintah County, Utah, that respondents wrongfully claim they are the owners of the same, and that they have refused to pay to appellant the royalties to which he is entitled following the discovery of oil on such lands in 1948. The prayer of the complaint seeks a decree to remove the cloud and quiet title in respondent, and in the alternative that certain conveyances of record be declared void and respondents Ray Phebus and Paul Stock compelled to execute a conveyance of such interest to appellant, or that the court decree that respondents hold the royalty interest in trust for the use and benefit of appellant, and finally for an accounting of the proceeds due appellant from the sale of oil which had been produced from said land.

Respondent Ray Phebus filed an answer disclaiming

any interest in the royalty involved (R. 4, 5). The remaining respondents filed an answer denying the right of recovery and pleading a number of affirmative defenses including limitations, failure of appellant to demand a reconveyance of his royalty interest, accord and satisfaction, estoppel and laches. Many of the facts are admitted by the pleadings and will be detailed hereafter.

The case was tried before the District Court at Provo, Utah, on June 1, 1953, and a memorandum decision filed on July 30, 1953 (R. 35), awarding judgment to respondents no cause of action. Findings, conclusions and decree were thereafter filed on September 3, 1953 (R. 38 to 44).

Facts

On February 23, 1925, appellant, W. N. Preas, acquired by grant from M. P. Smith and Ellen M. Smith, his wife, in perpetuity, a royalty interest of 1% of the oil and gas in and upon 480 acres of land located in Township 5 South Range 22 East Salt Lake Meridian (Exhibit A), which was duly recorded.

Thereafter on October 11, 1930, Lucius A. Dick, James Wash Sheridan, J. N. Wyman, Ida H. Sheridan, Francis Hamilton Sheridan, N. J. Meagher and W. N. Preas, Appellant herein, as owners of oil and gas royalty interests in and to 440 acres of the lands described in Exhibit 1, executed an agreement with respondents Paul Stock and Ray Phebus (Exhibit C), which was duly recorded. As this agreement is in one respect the focal point of the controversy herein, the same is set forth in full, excluding only the signatures:

(Typographical errors are those of the exhibit.)

"Entry No. 8378

ASSIGNMENT ROYALTY INTEREST

This agreement and assignment made this 11th day of October 1930 between the undersigned owners, partie parties of the first part, and Paul Stock of Cody, Wyoming and Ray Phebus of Thermopolis, Wyoming parties of the second part,

WITNESSETH

Whereas the parties of the first part are the owners of certain royalties in the gas now being produced and that may hereafter be produced from the following described lands situated in the County of Uintah, State of Utah, to-wit:-

South East quarter ($SE\frac{1}{4}$), of Southeast quarter ($SE\frac{1}{4}$) of Section fifteen (15) East half $E\frac{1}{2}$) of Northeast quarter ($NE\frac{1}{4}$) and the Northeast quarter ($NE\frac{1}{4}$) of the Southeast quarter ($SE\frac{1}{4}$) of Section twenty two (22) Northwest quarter ($NW\frac{1}{4}$) of the Northwaet quarter ($NW\frac{1}{4}$); South half ($S\frac{1}{2}$) of Northwest quarter ($NW\frac{1}{4}$); Southwest quarter ($SW\frac{1}{4}$) of Northeast quarter ($NE\frac{1}{4}$); North half ($N\frac{1}{2}$) of Southwest quarter ($SW\frac{1}{4}$) and the Northwest quarter ($NW\frac{1}{4}$) of the Southeast quarter ($SE\frac{1}{4}$) of Section twenty three (23) Township Five (5) South, Range Twenty two (22) East;

and whereas said parties of the first part are also the owners of certain royalties in the oil which may be hereinafter be produced and saved from said land; AND WHEREAS the parties of the second part are the owners of certain Interests in the Oil and Gas that may be produced from said land and are desirious of negotaiting with a responsible oil production Company for the

drilling of a deep test well on said ground, but cannot perfect said negotiations due to the fact that there are now outstanding royalties of eighteen and one-half ($18\frac{1}{2}$) percent which it is desirable to reduce to a total Royalty of twelve and one half ($12\frac{1}{2}$) percent; AND WHEREAS such drilling well not only test such land for oil, *but offers the possibility of further developing the gas production from said land to the benefit of the holders of said gas royalties.*

NOW THEREFOR: in consideration of the premises of procuring the drilling of a deep test well on said land, for the consideration of One Dollar (\$1.00) and other valuable considerations the undersigned parties of the first part, being the owners of the respective royalties interests as hereinafter set opposite their respective signatures, do hereby sell, assign and set over unto the parties of the second part One third $\frac{1}{3}$ of their respective royalty interests in the oil produced and saved from said land.

IT IS EXPRESSTY UNDERSTOOD AND AGREED That this assignment does not apply to the royalty interests of said parties of the first part in gas produced from said land. *This assignment is made for the purpose of procuring the drilling of a well to test the said land for oil under the agreement between the said Paul Stock and Ray Phebus on the one part and the Standard oil company of California and/or one of its subsidiaries, on the other part, hereinafter designated as the operating Company. If the negotiations of the said Paul Stock and Ray phebus shall result in the drilling, within the limitations hereinafter provided of a test well upon the Ashley Valley Structure to the depth of the pennsylvanain formation or to such lesser debth as shall produce Oil*

in commercial quantities, then this assignment shall be at full force and effect as to the oil royalties hereinafter set forth. It is understood that the limitations above referred to are as follows, the said operation company is to commence said well on the Ashley Valley structure within six months after the completion of the deep test well which shall first be drilled on the Rangley structure in Northwestern Colorado, said well on the Rangley structure shall be commenced as soon hereafter as weather conditions will permit and not later than the summer of 1931, after the commencement if each of the said wells, the drilling operations shall be presented with reasonable diligence. If said test well upon the Ashley Valley structure shall not be drilled as herein contemplated, then in that event the parties of the second part hereby agree to reconvey the royalty interests herein assigned to them to the respective parties of the first part. In Witness whereof we have hereunto set our hands and set opposite our respective names the presentage of royalty interest affected by this agreement and have caused this assignment of One third $\frac{1}{3}$ thereof to be executed.

NAME	Royalty
Lusius A Dick	$\frac{1}{2}\%$
James Wash Sheridan	1%
J. N. Wyman	$\frac{1}{2}\%$
Ida H. Sheridan	$\frac{1}{2}\%$
Francis Hamilton Sheridan.	1%
Mayme Wyman	
N. J. Meagher	2%
W. N. Preas	1%
<i>parties of the first part;</i>	
Ray Phebus	
Paul Stock	
<i>parties of the second part; "</i>	

Since the Clerk has numbered all of the Transcript of Proceedings as page 45 of the Record, we shall refer hereafter to pages of such Transcript with the letter "T".

With reference to Exhibit C, it was stipulated by the parties that a well was drilled on the Rangely Structure in Northwestern Colorado by Standard Oil Company of California or one of its subsidiaries, and that such well was spudded in on May 19, 1931 and completed on July 31, 1933, at a depth of 7,155 feet. This well was the deep test well on the Rangely Structure referred to in Exhibit C (T. 10). It was likewise stipulated (T. 10) that neither the Standard Oil Company of California, its wholly owned subsidiary the California Company, nor any other subsidiary of Standard Oil Company of California referred to in Exhibit C, commenced a well within six months after the completion of the test well on the Rangely Structure on July 31, 1933, nor at any other time drilled any oil or gas well upon the 440 acres of land described in Exhibit C. *The conditions precedent to the effective assignment set forth in exhibit C were never performed.*

Subsequent to the execution of Exhibit C and on April 30, 1931, Ray Phebus and Paul Stock entered into a contract with Standard Oil Company of California with reference to drilling operations on said land (Exhibit D). On November 30, 1931 Paul Stock and Ray Phebus assigned to Standard Oil Company of California such oil royalties as they had acquired, among other royalties, under the assignment of October 11, 1930, set forth above as Exhibit C (Exhibit F). On December 31, 1931 the

Standard Oil Company of California assigned its rights acquired under the grants to it from Phebus and Stock of April 30, 1931 and November 30, 1931 to its wholly owned subsidiary the California Company (Exhibit G). On March 21, 1934, the California Company assigned back to Ray Phebus and Paul Stock all of its oil and gas rights acquired in the property reciting that it had elected not to commence the drilling of a test well on the Ashley Valley Structure (Exhibit H).

There are in the record a number of exhibits affecting title to the property and the oil and gas rights located in and upon the same, dated subsequent to the reconveyance to Phebus and Stock of the California Company. On January 19, 1945 Ray Phebus and Ella Phebus, his wife, quit claimed to respondent Joe T. Juhan, all of their right, title and interest in and to said lands (R. 15). On April 14, 1945, Paul Stock quit claimed his interest in said lands to Charles S. Hill (R. 15). On January 5, 1946, Charles S. Hill and Virginia W. Hill, his wife, quit claimed their interest in said lands to Joe T. Juhan (R. 15). On July 12, 1948, Joe T. Juhan and Genevieve Juhan, his wife, quit claimed to Paul Stock an undivided $\frac{1}{4}$ interest in said lands (R. 15). On January 11, 1946, Joe T. Juhan and Genevieve Juhan, his wife, quit claimed to respondent Equity Oil Company an undivided $\frac{1}{2}$ of their interest in said lands (R. 15). On December 30, 1947, Equity Oil Company quit claimed to Weber Oil Company all of its right, title and interest in and to said lands (R. 16).

On December 30, 1948, respondents Equity Oil Com-

pany and Weber Oil Company, Joe T. Juhan and Paul Stock made and entered into an operating agreement wherein Weber Oil Company, Joe T. Juhan and Paul Stock were designated as non-operators, and Equity Oil Company was designated as operator. Under the terms of this agreement, the 440 acres of land here involved were to be drilled, developed and operated for the purpose of exploring, developing and removing oil and gas therein contained, and Equity Oil Company was given certain liens upon the oil and gas derived from said lands as protection for their expenditures, and as such operators likewise were charged with and did distribute royalty payments to the various royalty owners (Exhibit I, to which is attached the accounting procedures to be followed).

All of these various agreements and deeds were duly recorded in the Office of the County Recorder of Uintah County at Vernal, Utah.

The signature of appellant on Exhibit C was notarized on October 17, 1930 (T. 14). Appellant did not prepare or request preparation of the agreement, and so far as he can recall he had not actually seen it prior to the date on which it was executed (T. 14).

Exhibit C states that "In consideration of the premises of procuring the drilling of a deep test well on said land for the consideration of \$1.00 and other valuable consideration" Appellant tendered proof that he did not receive the \$1.00 referred to in Exhibit C, which tender was rejected by the Court (T. 16).

The property involved in this action lies approximately

8 to 8½ miles away from Vernal (T. 31). At the time of execution of Exhibit C in 1930 appellant was in the sheep business (T. 13), and spent a generous portion of his time in various states buying and selling such livestock.

In 1943 Joe T. Juhan was engaged in salvaging pipe near the property in question which had been used to place gas in the town of Vernal (T. 55), of which appellant was aware. In 1946 appellant was present for a part of one day at the Vernal Court House where the trial of *Meagher v. Uintah Gas Company and Valley Fuel Supply*, 185 P. (2d) 747, was in progress (T. 82). He testified that this case did not involve any problems with reference to the oil royalty which is the subject of present litigation (T. 68).

In July of 1948 appellant saw a bulldozer working on the property, and was advised by a workman that he thought that an oil well was going to be erected (T. 28). This was the first time that appellant had any knowledge or information whatsoever that anyone was drilling or proposing to drill an oil well on the property here involved (T. 28). His first knowledge that a well was actually being drilled for oil was in July 1948 when he saw a rig going up (T. 27 and 28) but he had no idea as to who was drilling or proposing to drill such an oil well. Equity Oil Company, the operator under Exhibit I, which was the agreement actually dated December 30, 1948, between itself, Weber Oil Company and Juhan and Stock, spudded in a well on the property on August 1, 1948, which was completed as a producing well on September 18, 1948 (T. 75).

About noon of November 18, 1948, appellant received a check from the Equity Oil Company (Exhibit K), which contained an endorsement, from which he gathered for the first time that there was some question as to whether or not there was an adverse claim to his $\frac{1}{3}$ of 1% oil royalty (T. 18). *So far as he knew this was the first information from any source that there was such an adverse claim on the part of respondents or their predecessors in interest in existence subsequent to 1933* (T. 17). On that same afternoon he attempted to call Mr. Paul Stock at Cody, Wyoming (T. 18) where he was advised that Stock was at the Brown Palace Hotel at Denver, Colorado (T. 18). He reached him later that afternoon, advised him that he had received the first royalty check and asked him what was meant by the endorsement referring to the $\frac{1}{3}$ of 1%. Stock then advised appellant that the Stock and Phebus agreement was a long time ago and that he didn't recall the particulars but would look into it and advise appellant (T. 18). Shortly thereafter appellant contacted J. L. Dougan, President of the Equity Oil Company, when he again asked about the $\frac{1}{3}$ of 1% royalty, and was advised that the only thing Dougan could do would be follow the advice of his attorney, and that if Paul Stock executed a reconveyance he would be glad to make payment for the royalty on the $\frac{1}{3}$ of 1% (T. 22). Appellant continued his efforts to reach Stock, who shortly after Christmas of 1948 had gone to the Hawaiian Islands (T. 23). In March of 1949 he talked to Stock and arranged a meeting at Salt Lake City with him (T. 24) for the following day.

Stock was not present for such meeting (T. 24), and appellant was not able to see him prior to the commencement of the initial action, notwithstanding a determined effort to do so (T. 25 and 26).

Prior to November 1948, appellant had not requested reassignment of the $\frac{1}{3}$ of 1% royalty from any of the respondents herein, as he was very sure they had no interest in his full 1% royalty (T. 48). On April 12, 1949, acting upon the advice of counsel, appellant wrote a letter to Paul Stock at Cody, Wyoming, wherein he stated that Mr. Phebus, Mr. Dougan and Mr. Juhan had all assured him they were willing to reconvey, and also that Phebus stated he thought this had been done a long time ago. In this letter he also mentioned the possible necessity of a law suit and requested Stock to execute an assignment which was enclosed, and which the letter stated would constitute a purchase on his part of $\frac{1}{3}$ of 1% (Exhibit 2, T. 50). Enclosed with this letter was a post office money order for \$10.00 (T. 51). Because of his previous experience with the Bank of Vernal, he was under the impression that any such document required a monetary consideration for its validity (T. 60). At this time appellant had received monthly royalty checks from Equity Oil Company based upon $\frac{2}{3}$ of 1% of royalty (there has never been any dispute as to his ownership of this fractional interest) for a period of five months (T. 59), totaling \$319.53 (Exhibit J), and he entertained no thought whatsoever that the \$10.00 payment was in any way to represent the value of the royalty or an actual purchase of any royalty interest (T. 60, 61).

On December 29, 1927, W. N. Preas and Ella L. Preas, his wife, executed a quit claim deed to said land to N. J. Meagher of Vernal, Utah (Exhibit B). When it appeared that through inadvertance this had included the royalty interest of appellant, on November 28, 1931, N. J. Meagher and appellant executed an agreement and assignment stating that said quit claim deed was not intended to and did not transfer the royalty interest, and formally quit claiming such interest back to appellant (R. 13). Later on, on April 28, 1948, N. J. Meagher prepared and executed an identical instrument (Exhibit I).

The only witness who appeared in behalf of respondents was Joe T. Juhan (T. 75). He stated that in April, 1948, he had held a conversation with appellant at Vernal and advised him that a well was going to be drilled and that appellant should get a deed from Meagher for his royalty, and that he didn't think Meagher would ever give him a deed (T. 77). He went on to testify that notwithstanding the fact that he had seen appellant a number of times subsequent to 1943, he had never discussed the agreement between appellant and Phebus and Stock (Exhibit C) with him (T. 88). Further, he had examined the records in Uintah County in 1943, and had seen a copy of this agreement, and that he knew at that time that no well had been drilled on the Ashley Valley Structure lands here involved (T. 83, 85 and 86). When asked why it was that he felt appellant had no interest in the oil royalty he stated (T. 88): "Because I had seen a document of record someplace where he had assigned it to Meagher, but I never found where Meagher had assigned

it back to him." Later, he changed this statement to include the Phebus and Stock agreement (R. 91).

At the time of drilling the well, Juhan testified that he had relied upon the record title and the Supreme Court decision (T. 80), which decision was *Meagher v. Uintah Gas Company and Valley Fuel Supply*, 185 P. (2d) 747 (T. 82). He continued that he understood that this decision was relative to a modification agreement, and didn't know whether or not it involved the Phebus and Stock agreement (T. 89). In fact, there was no issue nor reference in this case to such agreement. When asked whether the well would have been drilled, Juhan replied that they probably would not have drilled with an outstanding royalty of 18½% (T. 90).

The issue in this case involves only one third of the 1% royalty received by appellant from M. P. Smith (Exhibit A). Following the issue of the initial royalty check on November 17, 1948 by Equity Oil Company, based upon two-thirds of the 1% interest, which check was the first notice appellant had that the respondents claimed any interest in the one third interest, respondent Equity Oil Company continued to forward such checks each month thereafter. A summary of these checks is contained in Exhibit J, and fifty percent of the total amount would equal the value of the one-third of 1% royalty payments, or \$9,284.88, as appellant does not question the accounting accuracy of this Exhibit. Appellant has not cashed, pledged, or in any way used these checks because of the endorsement placed thereon by Equity Oil Company, notwithstanding the fact that there

has never been the slightest question as to his right to receive the amounts of these checks which represent proceeds of the remaining $\frac{2}{3}$ of 1% royalty. The endorsement reads as follows:

“Payment in full oil produced and sold during October 1948 Ashley Valley No. 1 well under Modification Agreement dated May 21, 1927; royalty interest 1% from M. P. Smith February 3, 1925, less assignment $\frac{1}{3}$ of 1% to Paul Stock and Ray Phebus October 11, 1930; and the payee, by endorsement of check attached, represents that he is the holder and owner of the royalty interest in the amount stated.”

STATEMENT OF POINTS

Appellant relies upon the following points:

POINT I. THAT THE TRIAL COURT ERRED IN MAKING AND ENTERING ITS CONCLUSIONS OF LAW, FOR THE REASON THAT THE SAME ARE CONTRARY TO THE EVIDENCE AND STIPULATED FACTS, AND AGAINST LAW.

POINT II. THAT THE TRIAL COURT ERRED IN MAKING AND ENTERING JUDGMENT IN FAVOR OF RESPONDENTS AND AGAINST APPELLANT, NO CAUSE OF ACTION, FOR THE REASON THAT SAID JUDGMENT IS CONTRARY TO THE EVIDENCE AND STIPULATED FACTS, AND AGAINST LAW.

POINT III. THAT THE TRIAL COURT ERRED IN MAKING AND ENTERING ITS FINDINGS OF FACT, THE SAME BEING CONTRARY TO THE EVIDENCE AND STIPULATED FACTS.

POINT IV. THAT THE TRIAL COURT ERRED IN REFUSING APPELLANT'S TENDER OF PROOF THAT APPELLANT DID NOT RECEIVE \$1.00, WITH REFERENCE

TO THE EXECUTION OF THE AGREEMENT BETWEEN APPELLANT AND PHEBUS AND STOCK, FROM WHICH ANY RIGHT OF RESPONDENTS MUST ORIGINATE.

ARGUMENT

POINT I. THAT THE TRIAL COURT ERRED IN MAKING AND ENTERING ITS CONCLUSIONS OF LAW, FOR THE REASON THAT THE SAME ARE CONTRARY TO THE EVIDENCE AND STIPULATED FACTS, AND AGAINST LAW.

POINT II. THAT THE TRIAL COURT ERRED IN MAKING AND ENTERING JUDGMENT IN FAVOR OF RESPONDENTS AND AGAINST APPELLANT, NO CAUSE OF ACTION, FOR THE REASON THAT SAID JUDGMENT IS CONTRARY TO THE EVIDENCE AND STIPULATED FACTS, AND AGAINST LAW.

Both of the first two points are concerned with the fact that the Trial Court failed to properly construe the basic agreement between appellant and Phebus and Stock, under which no right vested until there had been a performance of the condition set forth, and which contemplated the drilling of a well upon the lands in question by Standard Oil Company, or its subsidiary, within the time limits indicated. For this reason these points will be considered together under the following headings.

A. An oil royalty is an interest in real property.

The case is essentially a quiet title action to remove a cloud evidenced by Exhibit C. In determining the nature and effect of this agreement, it is necessary to establish the nature of the royalty interest with which such instrument is concerned, i.e., whether that royalty is real property or personalty. This question, so far as

appellant can determine, is of first impression in Utah. Appellant's position is that the royalty here involved is real property.

As the discovery of oil in other states produced litigation in the field of oil and gas law, there was an early confusion in the cases from such jurisdictions on this question. This arose principally because of the migratory nature of oil beneath the land surface, which distinguished it from other minerals. In the early stages of the legal development in the various states concerned with oil rights, the courts reached the conclusion that interests in oil and gas, whether royalty or otherwise, are interests in real property. This is the position of all states today in which the question has arisen, although there is a variance as to the precise nature of that real property interest. See annotations: *Oil and Gas Royalty as Real or Personal Property*, 90 A.L.R. 770; 101 A.L.R. 884; 131 A.L.R. 1371.

In *Tennant v. Dunn*, 110 S.W. (2d) 53, the Texas view is summarized as follows:

“While there was, prior to the decision of *Sheffield v. Hogg*, 124 Tex. 290, 77 S.W. (2d) 1021, 1024, 80 S.W. (2d) 741, confusion in the opinions of the courts of this state as to the nature of royalty interests, it is settled by that decision that royalties, whether payable in money or in kind, issuing out of the ordinary oil and gas leasehold estate, a determinable fee, ‘are interests in land; and hence not subject to parol sale, but have the protection of the statute of frauds, the statutes regulating conveyances and mortgages of real estate, and the statutes requiring the record

of instruments affecting title to or liens on land.' ”

“The gist of the opinion in *Sheffield v. Hogg* is that oil and gas royalties, whether payable in kind or in money, and whether arising from the ordinary lease of land in which the lessor owns the minerals, or from a lease made under the Relinquishment Act, should be adjudged to be present interests in land rather than mere rights in personalty at some uncertain date, because they are profits arising out of land, and, further, because such classification, which accords with the practice in the oil and gas industry, furnishes a stability highly important, if not essential to the structure of that business. For the same reasons, the right created by the assignment to Mrs. Dunn should be classified as an interest in land.”

Sheffield v. Hogg, 77 S.W. (2d) 1021, 1024, 80 S.W. (2d) 741, indicates a practical reason why oil and gas royalties should be treated as real property:

“The oil industry in Texas is largely dependent for development, growth, or prosperity, on the doctrine that the interests we are considering—such as the Lessee’s and the Lessor’s estates under contracts which are in customary use in Texas—are interests in land; and hence not subject to parol sale, but have the protection of the statute of frauds, the statutes regulating conveyances and mortgages of real estate, and the statutes requiring the record of instruments affecting title to or liens on land, so that purchasers can rely on deed and lien records and can execute and receive transfers and conveyances in reliance on true abstracts of title and lawyers’ correct opinions thereon. Were the stability furnished by these rules withdrawn and the fundamental contracts, on which the oil business so largely rests,

be adjudged by the Supreme Court to create mere rights in personalty at some uncertain date in the future, the structure of the business would be seriously, if not fatally, jeopardized."

The decision in *Callahan v. Martin*, 43 P. (2d) 788, (Calif.), likewise holds that royalty interests are real property, but upon a different premise than the Texas view. Thus at page 791:

"Some jurisdictions adhere to the theory that the owner of land has as estate in oil and gas beneath the surface in like manner as he has an estate in the surface; that oil and gas in place beneath the surface of land constitute a part of the land, and as such are real property, may be granted separate and apart from the surface, and when so granted vest in the assignee an estate in definite corporeal real property. This theory cannot be better enlarged upon than by the following quotation from *Texas Co. v. Daugherty*, 107 Tex. 226, 176 S.W. 717, 719, 720, L.R.A. 1917F, 989:

"'It is no longer doubted that oil and gas within the ground are minerals. They have peculiar attributes not common to other minerals because of their fugitive nature or vagrant habit—the disposition to wonder or percolate, and the possibility of their escape from beneath one part of the surface of the earth to another. Nevertheless, they are to be classed as minerals. (Citing authorities) In place, they lie within the strata of the earth, and necessarily are a part of the realty. Being a part of the realty while in place, it would seem to logically follow that, whenever they are conveyed while in that condition or possessing that status, a conveyance of an interest in the realty results. It is generally conceded that, for the purpose of ownership and conveyance of

solid minerals, the earth may be divided horizontally as well as vertically, and that title to the surface may rest in one person and title to the strata beneath the surface containing such minerals in another. * * *

“ ‘If they are in place beneath the tract, they are essentially a part of the realty, and their grant, therefore, while in that condition, if effectual at all, is a grant of an interest in the realty. * * * Their conveyance while in place, if the instrument be given any effect, is consequently the conveyance of an interest in the realty.’ See, also, *Stephens v. Mid-Kansas Oil & Gas Co.*, 113 Tex. 160, 254 S.W. 290, 29 A.L.R. 566, note, 585; *Leonard v. Prater* (Tex. Com. App.) 36 S.W. (2d) 216, 86 A.L.R. 499, note, 506.”

The decision’s reasoning turns to the early common law for analogy, and concludes that an oil royalty is a profit a prendre, and an estate in realty. At page 793, it states:

“* * *Of the ancient incorporeal hereditaments listed by Blackstone, several either are not recognized at all in this country, or, if they do not involve rights in or to land, are not classed as things real. But a number of the common-law incorporeal hereditaments which involve rights connected with or pertaining to land persist, and are recognized generally as a species of interest in land, or estate in real property. (Citing authorities.)

“The incorporeal hereditament of common is defined by Blackstone as ‘being a profit which a man hath in the land of another; as to feed his beasts, to catch fish, to dig turf, to cut wood, or the like.’ *Cooley’s Blackstone*, supra, p. 455. These

are the rights which are described as profits a pendre, and they may be several as well as in common. See, discussion, 2 Tiffany, Real Property, 1394."

"Jurists writing since Blackstone's time have remarked that his inclusion of incorporeal hereditaments, together with lands and tenements, as "things, or objects in which dominion or property may be had, is somewhat misleading. See 1 Tiffany, Real Property (2d Ed.) p. 9, note 27, citing Austin, Jurisprudence (3d Ed.) 371, 804; Digby, History Real Property (4th Ed.) 304, note; Hohfeld, 23 Yale Law Journal, p. 23; Salmond, Jurisprudence (4th Ed.) 220. Where the incorporeal hereditament relates or pertains to land, it is, rather, a designation of a certain class of rights in and to land, just as an estate in fee simple absolute is the designation applied to the rights and interests of the person who has the fullest and most absolute estate in lands known to the law. That rights in and to land, though they are embraced within the definition of an incorporeal hereditament, constitute a limited interest or estate in land, is generally recognized. (See cases cited second paragraph above.) Where this limited interest is to endure in perpetuity or for life, it is a freehold interest, and real property or real estate, as well as an estate in real property."

Again at page 795:

"The royalty return which the lessee renders to his lessor for this estate in the land is rent, or so closely analogous to rent as to partake of the incidents thereof. In the lease in the instant case, executed by Gonzales through his guardian, the lessor's oil royalty is referred to as 'rent or royalty.' In discussing the nature of landowner's

royalties, the Supreme Court of the United States said in *United States v. Noble*, 237 U.S. 74, 35 S. Ct. 532, 535, 59 L. Ed. 844:

“The rents and royalties were profit issuing out of the land. When they accrued, they became personal property; but rents and royalties to accrue were a part of the estate remaining in the lessor. As such, they would pass to his heirs, and not to his personal representatives. * * *

“It is said that the leases contemplated the payment of sums of money, equal to the agreed percentage of the market value of the minerals, and thus that the assignment was of these moneys; but the fact that rent is to be paid in money does not make it any the less a profit issuing out of the land.’ ”

At page 796:

“* * * In this analysis, the assignee of an oil royalty not limited to the duration of a particular lease has a right in the nature of a profit a pendre in the land, and this right constitutes an interest in said land an estate in real property. * * *

See also *Payne v. Callahan*, 99 P. (2d) 1050, (Calif.).

In *Arrington v. United Royalty*, 65 S.W. (2d) 37:

“We have held that leases given for a definite period in which exploration and discovery of the mineral might be made, to continue as long thereafter as oil and gas is produced conveys not merely a license but an interest and easement in the land itself. *Standard Oil Co. v. Oil Well Salvage Co.*, 170 Ark. 729, 281 S.W. 360; *Clark v. Dennis*, 172 Ark. 1096, 291 S.W. 887; *Henry v. Gulf Refining Co.*, 176 Ark. 133, 2 S.W. (2d) 687; and *Henry v. Gulf Refining Co.*, 179 Ark. 138, 15

S.W. (2d) 979. As a consequence of this rule, our court has held that an attempted conveyance of the royalty reserved by parol is void, this, of course, being on the theory that the royalty was an interest in real estate."

See also *Marias River Syndicate v. Big West Oil Co.*, 38 P. (2d) 599, (Mont.); *Mark v. Bradford*, 23 N.W. (2d) 205 (Mich.).

- B. The Agreement (Exhibit C) between Appellant and Phebus and Stock from which the one-third of one per cent oil royalty in litigation must arise, terminated by its own terms in January, 1934, as the condition on which the grant was to become effective, requiring Standard Oil Company, or one of its subsidiaries, to drill a well on the property involved, was not performed.**

Exhibit C is the basic instrument from which any right or interest of respondents to the one-third of one per cent oil royalty must arise. When Phebus and Stock failed to perform the condition of such agreement and to drill a well as contemplated, no right ever vested in them so far as the one-third of one per cent royalty is concerned, since the agreement contemplated that they were to receive this royalty interest only if they performed the condition and drilled such well within the time limitation set forth, and under the facts of this case, such time expired in January, 1934, long prior to the Equity Oil Company well in 1948.

This instrument recites that appellant, among others, and Phebus and Stock were the owners of oil royalties in the lands described therein, and that it was desired to negotiate with a responsible oil production company

for the drilling of a deep test well on said ground which would not only test such land for oil, but would offer the possibility of further developing the gas production from the land to the benefit of the holders of gas royalties in it, as gas was then being produced. The recitals also state that in order to perfect the drilling arrangements, it was desirable to reduce the outstanding oil royalties.

These recitals are an indication of the intention existing in the minds of the parties at the time this instrument was executed. The agreement was to have a limited duration, not only because there was a desire to test for oil, but because gas was then being produced from the property and the parties desired to further develop the gas production for the benefit of the holders of the gas royalties. Certainly these gas royalty holders did not contemplate an increase in production some eighteen years later. In addition, there is a specific reference to a responsible oil company, which is later affirmatively identified as the Standard Oil Company of California, or one of its subsidiaries. As appellant testified, there had been a previous discovery of oil, although not in commercial quantities (T. 34), and he knew that Standard Oil Company was financially able and experienced in oil matters (T. 26). In short, a specific drilling by this particular company within a limited time was in the minds of the parties.

Turning to the body of this instrument, there next appears the consideration upon which the assignment of the oil royalty interest was based:

“NOW THEREFOR: in consideration of the premises of procuring the drilling of a deep test well on said land, for the consideration of One Dollar (\$1.00) and other valuable considerations the undersigned parties of the first part, being the owners of the respective royalties interests as hereinafter set opposite their respective signatures, do hereby sell, assign and set over unto the parties of the second part One third $\frac{1}{3}$ of their respective royalty interests in the oil produced and saved from said land.”

This language, when considered in connection with the balance of the agreement, clearly shows that the consideration for the execution of this agreement was nothing more or less than the drilling of an oil well. The fact that there is a recital with reference to the payment of \$1.00 does not in any way change the real consideration, and, in fact, the dollar is obviously purely nominal, as it does not bear any reasonable relationship to the values with which the instrument was concerned. Further, evidence relative to such intent of the parties is clear from the fact that appellant never received such amount. Proof of this fact was made by tender, (T. 16, 17), and the refusal of the Trial Court to accept such tender has elsewhere been assigned as error. A similar situation arose in *People's Gas Co. v. Dean*, 193 F. 938, (C.C.A. 8, 1911). In that case the Court pointed out that under a somewhat similar agreement the real and only consideration was the drilling of a well. The reasoning of the opinion is well set forth at page 942 as follows.

“When we come to examine the lease or contract under consideration, we think it perfectly

clear that it was made for the purpose of exploring and developing the land for gas and oil. While the consideration was primarily \$1, it is very evident from the terms of the contract that the prospective benefits and profits from gas and oil were the real and vital considerations moving the contracting parties. As was said by the Supreme Court of Indiana, in the case of *Hancock v. Diamond Plate Glass Co.*, 37 Ind. App. 351, 75 N.E. 659:

“To the landowner the manifest inducement was the rent and royalties he expected to enjoy if the gas company should find gas or oil in paying quantities; to the gas company the right to exclude others from the premises it should drill. It will not do to believe that the landowner would for the pittance of 50 cents per acre per annum have knowingly incumbered his land, situate in the gas district, and thereby reduced its selling value by transferring, for an indefinite period, and for speculative purposes, the right to enter at the pleasure of the grantee or his assignee and mine the underlying gas or oil, or that he would have bargained away his prospects for large gains from the gas and oil under his land, with the knowledge that the same would be extracted through wells on other premises, and that his profits would be limited to the annual acreage rent during the process of extraction.’”

See:

Shelden v. Bright, 10 P. (2d) 831, (Kans.);

17 C.J.S. 475, Sec. 128.

The balance of the instrument continues (typographical errors appear in exhibit).

“IT IS EXPRESSTY UNDERSTOOD AND AGREED That this assignment does not apply to the royalty interests of said parties of the first part in gas produced from said land. This assignment is made for the purpose of procuring the drilling of a well to test the said land for oil *under the agreement between the said Paul Stock and Ray Phebus on the one part and the Standard oil company of California and/or one of its subsidiaries, on the other part, hereinafter designated as the operating Company. If the negotiations of the said Paul Stock and Ray phebus shall result in the drilling, within the limitations hereinafter provided of a test well upon the Ashley Valley Structure to the depth of the pennsylvanian formation or to such lesser debth as shall produce oil in commercial quantities, then this assignment shall be at full force and effect as to the oil royalties hereinafter set forth.* It is understood that the limitations above reffered to are as follows, the said operation company is to commence said well on the Ashley Valley structure within six months after the completion of the deep test well whoch shall first be drilled on the Ranglely structure in Northwestern Colorado, said well on the Ranglely structure shall be commences as soon hereafter as weather conditions will permit and not later than the summer of 1931. after the commencement if each of the said wells, the drilling operations shall be presented with reasonable diligence. If said test well upon the Ashley Valley structure shall not be drilled as herein contemplated, then in that event the parties of the second part hereby agree to reconvey the royalty interests herein assigned to them to the respective parties of the first part. In Witness whereof we have hereunto set our hands and set opposite our respective

names the presentage of royalty interest affected by this agreement and have caused this assignment of One third $\frac{1}{3}$ thereof to be executed."

Again reference is made to the purpose of the agreement to procure a well "under the agreement between the said Paul Stock and Ray Phebus on the one part and the Standard Oil Company of California and/or one of its subsidiaries, on the other part". There was therefore in existance an agreement with Standard Oil, and the parties were not attempting to develop the property with any oil company which would drill, or in a general way, but under a specific agreement which required only for final completion of the reduction of royalties outstanding from $18\frac{1}{2}\%$ to $12\frac{1}{2}\%$. The agreement then provides that IF this well is drilled, THEN the assignment shall be at full force and effect. Thereafter appear the limitations referred to which place a definite time limit upon the performance of the well drilling. The intent is obvious. *Unless* the well is drilled, no interest in the fractional oil royalty is to pass or remain in Phebus and Stock, and it seems perfectly obvious that this instrument by its terms is self executing. Whether the royalty interest ever passed, and it seems most logical that in fact it never did pass until the condition was performed, or whether it did pass under the control limitation of the condition makes little difference. In either event, no right, title and interest vested because of the expiration of the time period since the record is clear that no well at all was ever drilled upon this ground by Standard Oil Company or any of its subsidiaries, within the time

period contemplated or at all.

At the end of the agreement appears a covenant that Phebus and Stock agree to reconvey if the test well on the Ashley Valley "shall not be drilled as herein contemplated." This is in one sense surplusage, and does not conflict with the clear intent of the parties expressed above. It is completely logical and consistent, however. The interest here involved was viewed generally as an interest in real property, and in fact every instrument in this record was recorded in the office of the County Recorder in the same fashion that any standard deed would be recorded. This meant that the agreement was a matter of public record. Whether or not this well was ever drilled might be a fact within the knowledge of the parties, but in the event that they later desired to execute a conveyance of their royalty interest there would remain a factual question which would require clarification on the record, a typical cloud on title. It is entirely logical that the agreement make provision for such necessity should it ever arise, but it certainly did not alter and literally change the entire agreement and render the inclusion of the words IF and THEN meaningless. It was an ancillary afterthought, and since appellant in the instant case has never conveyed his interest nor attempted to do so, there has been no particular reason to demand reconveyance. He did demand a recognition of his interest, of course, when he discovered in 1948 that his ownership of the entire 1% royalty was questioned, and every page of the record of his testimony both subsequent to this time, and later, shows clearly his proper

conviction that because of the time limit expiration of the well drilling clause in 1934 he owned the royalty in its entirety. The clause does not require any affirmative act on the part of appellant such as demand, and is an *express covenant* without qualification to reconvey. Respondents entire position in this controversy is based upon the premise that they are entitled to take advantage of their own wilful breach of this covenant.

In general, one dominant fact of this agreement is of particular importance. While it extends to Phebus and Stock the right to secure permanently the one-third royalty interest by the act of completing the test well within the time limitations, which was six months after completion of the Rangely well, or early 1934, it does not compel them to take any action whatsoever in this regard. They suffer no loss or detriment, and there was no remedy or right in the grantors in the event the well was not drilled as agreed. As the cases hereinafter cited point out, this is a typical unilateral agreement and in reality nothing more than a specie of simple option, wherein the rights in the optionees Phebus and Stock matured only in the event they fulfilled the terms of acceptance.

The general rule of construction in oil and gas contracts and agreements is that they are to be construed strictly against the lessee or grantee and in favor of the individual making the grant. In some respects the rule is somewhat different than that applied to ordinary contract because of the highly speculative nature of the property involved. It will be noted moreover, that appellant did not prepare or cause the agreement to be prepared

(T. 15), and in fact had not seen it prior to the day of execution, at which time other parties had already affixed their signatures (Exhibit C). The cases indicate that the agreement should be construed, therefore, liberally in favor of the appellant.

In *Stanolind Oil & Gas Co. v. Guertzgen*, 100 F. (2d) 299 (C.C.A. 9) the rule is set forth at page 300:

“Oil and gas leases deal with property of a highly speculative nature, and the protection of the interests of the lessor is considered of paramount importance. In *Solberg v. Sunburst Oil Company*, 76 Mont. 254, 246 P. 168, it is declared that (page 172) ‘the well-known rules of construction of contracts, have in case of oil and gas leases, been modified to meet the new conditions arising by reason of the new industry, and such modification is necessary for the protection of the interests of the landowner and of the public generally.’ The Montana courts have consistently declared that in connection with such leases forfeitures are favored by the law. ‘Defendants argue that the courts view forfeitures with disfavor and will enforce them only when the strict letter of the contract requires it. This is a correct statement of a general principle of law, but in connection with oil and gas leases, forfeitures are favored by the law.’ *Berthelote et al v. Loy Oil Co.*, 95 Mont. 434, 28 P. 2d 187, 190. ‘*It is a recognized doctrine in this court that oil and gas leases are to be construed liberally in favor of the lessor and strictly against the lessee.*’ *McDaniel v. Hager-Stevenson Oil Co.*, 75 Mont. 356, 366, 243 P. 582, 586. Other cases dealing with the general subject are cited on the margin.

“The rule in vogue is not merely to the effect

that express provisions for forfeiture will be strictly enforced. An implied right of forfeiture will be enforced with equal strictness."

In *Hill v. Stanolind Oil & Gas Co.*, 205 P. 2d 643 (Colo.) at page 649:

"Among the rules for construction of a lease are the following: That it should be construed if possible so as to give effect to every provision contained in it; that it should be so construed as best to promote production, development and progress; *Parish Fork Oil Co. v. Bridgewater Gas Co.*, 51 W. Va. 583, 42 S.E. 655, 59 L.R.A. 566; *that it should be construed in favor of the lessor and against the lessee; that, when contracts are optional in respect to one party, they are strictly construed in favor of the party that is bound and against the party that is not bound; Lewis v. Grininger*, 198 Okl. 419, 179 P. 2d 463."

* *Lewis v. Grininger*, 179 P. 2d 463 (Okla.) involved the construction of an oil and gas lease and contains an indication of the practical application of the foregoing rule of construction. Paragraph five of the lease contained the following provision:

"If operations for the drilling of a well for oil and gas are not commenced on the land hereby leased on or before Dec. 25, 1942, this lease shall terminate as to both parties, unless the lessee shall on or before Dec. 25, 1942, pay or tender to the lessor * * * the sum of One Hundred Sixty Dollars which shall operate as a rental and cover the privilege of deferring the commencement of drilling operations on the land hereby leased for a period of twelve months. * * *"

Paragraph 15 of the lease was in conflict.

“ ‘It is agreed that neglect or failure to pay rentals when due shall not operate to forfeit or cancel this lease, until lessor gives lessee notice by registered mail of said failure to pay rental; whereupon lessee shall pay same within 10 days of receipt of said registered letter, or this lease is void.’ ”

In holding that the lease had in fact terminated, the court stated, at page 464 :

“Paragraph fifteen is in conflict with paragraph five and indefinite in its terms. It would extend the lease for a period of at least ten days beyond the term of twelve months as provided in paragraph five without payment of any sum to lessor, and for such further indefinite and uncertain length of time until lessee should receive by registered mail a notice by lessor of lessee’s failure to pay, and then at the option of lessee to expire by its terms unless lessee chose to make payment. This uncertainty and indefiniteness is made more apparent in the light of the facts in this case. The lease was made to Sungold Syndicate No. Two without showing any address of lessee and the assignment of the lease to defendant was not filed on record for more than two years after execution of the lease.

“The rules of construction applicable to this lease are stated in *Frank Oil Co. v. Belleview Gas & Oil Co., et al.*, 29 Okl. 719, 119 P. 260, 43 L.R.A., N.S., 487, where in the third and fourth paragraphs of the syllabus it is said :

‘A different rule of construction obtains as to oil and gas leases from that applied to ordinary leases or to other mining leases. Owing to the peculiar nature of the mineral,

and the danger of loss to the owner from drainage by surrounding wells, such leases are construed most strongly against the lessee and in favor of the lessor.

'When contracts are optional in respect to one party, they are strictly construed in favor of the party that is bound and against the party that is not bound.'

"Under the provisions of paragraph five the lease had terminated before the provisions of paragraph fifteen could become operative.

"If paragraph fifteen was effective for any purpose, it was not effective to prevent termination of the lease under paragraph five above quoted."

The agreement here involved is substantially what has been described as the "unless" lease in cases involving oil litigation. The distinguishing characteristic of such a lease is that the grantee or lessee is under no obligation to affirmatively perform any act whether it be that of drilling a well or paying rent, it is unilateral in nature, and essentially a specie of option. Under this type of agreement, no right vests until there has been a performance of the condition. This is substantially identical with the agreement here involved, as Phebus and Stock did not covenant to perform any act either by way of rental payment or drilling, there was no right in Preas of any kind to compell them to drill the well on the Ashley Valley Structure and no remedy if they failed to do so.

In Summers Oil and Gas, Permanent Edition, Vol. 2,

Sec. 452, page 494, appears a summary of the “unless” lease characteristics, and the distinction between that lease and an “or” lease which reads as follows:

“‘When the “unless” drilling clause is used, the lessee does not covenant to drill or pay. The clause relative to the drilling of wells within a stated time, or the periodic payment of money is used, not for the purpose of fixing a duty upon the lessee to drill or pay, but to state a limitation upon which the lease terminates if these acts are not performed. *Consequently, if the lessee fails to drill within the stipulated time, the lessor cannot recover in an action for rent, or recover in an action for damages for failure to drill, for the obvious reason that there is no duty on which to found such actions.*

“‘Where the “drill or pay” clause is used, the courts uniformly hold that the interest of the lessee is subject to be defeated by breach of condition subsequent; that is, the failure of the lessee to drill or pay within the time or times stipulated in the lease. This power to forfeit the lease is for the benefit of and exercisable by the lessor or his assigns only. Before the lease is terminated by this power, there must be a declaration of forfeiture by the lessor and a perfection thereof, by re-entry, action or other operative act.

“‘But where the “unless” drilling clause is used, the failure of the lessee to drill or pay a stipulated sum of money ipso facto terminates the lease without the necessity of re-entry, action, or their equivalents by the lessor.’ (*Citing Gloyd v. Mid-West Refining Company*, supra.) ‘For this reason the interest created by the lessee by such lease cannot be one terminable by breach of conditions subsequent. Some courts have designated

them options or optional leases, but the interests created by them are perhaps better classified as estates upon common law limitation, wherein the interest of the grantee or lessee continues until the happening of the event upon which they terminate * * * Some courts have held that the interest created by this sort of lease is one on common law limitation.

“If the interest created by the “unless” lease is classed as an interest upon common law or special limitation, it is difficult to see how the termination by failure of the lessee to drill wells or to pay the sums stipulated therein for the continuance of his privilege of drillings, can be accurately termed a forfeiture, or a decree of a court of equity cancelling such a lease or quieting the lessor’s title in respect to it, the enforcement of a forfeiture. But whether this terminology be finally accepted by the courts to designate the nature of the interest of the lessee, they nevertheless agree that the lease automatically terminates by its own terms without the exercise of any power on the part of the lessor, and this prevents the interest from being one subject to be defeated by conditions subsequent, the enforcement of which is so thoroughly abhorred by courts of equity. *It is no doubt true that, where an “unless” lease has terminated for the failure of the lessee to drill test wells or to pay delay rentals within time or times stipulated, the lessor has a right to have the cloud thereof removed from his title.* * * *”

Gloyd v. Midwest Refining Co., 62 F. 2d 483 (C.C.A.

10) defines an unless lease as follows:

“Under an ‘or’ lease the lessee is obligated either to drill a well or pay rental, and the failure to pay rental does not terminate the lease; and

where the lessee makes default in the payment of rental the lessor may waive the default and recover such rental. (Citations)

“But under an ‘unless’ lease the lessee is not obligated either to commence a well or pay rental. Until a well has been drilled and oil or gas produced, such a lease is terminable at the will of the lessee, and where no well has been commenced such a lease automatically terminates upon the intentional failure of the lessee to pay the stipulated rental within the time provided in the lease. (Citations).”

“The weight of authority is to the effect that an ‘unless’ lease, until the lessee has gone into possession, drilled a well, and commenced the production of oil or gas from the leased premises, conveys no vested interest in the land itself and is only an option to go upon the land and explore for oil and gas. (Citations) But when the lessee has gone upon the premises, completed a well, and produced oil or gas therefrom, he then acquires a vested interest for the term of the lease and becomes bound by all the covenants of the lease, express and implied. (Citations).”

In *Bowes v. Republic Oil Company*, 252 P. 800 (Mont.), at page 802:

“It is the plain intention of the parties and not the mere wording of a lease which fixes its nature as an ‘or’ lease or an ‘unless’ lease, as defined in *McDaniels v. Hager-Stevenson Oil Co.*, 75 Mont. 356, 243 P. 582. *In this connection it must be remembered that such leases as this are executed for the purpose of having lands explored, tested, and drilled to determine whether oil and gas may be found therein, and, therefore, to the*

end that development may be promoted and delays therein prevented (New State Oil Co. v. Dunn, 75 Okl. 141, 182 P. 514), they are to be construed liberally in favor of the lessor and strictly against the lessee. (Citations).

“While forfeitures are not usually favored in the law, owing to the peculiar nature of oil and gas leases, forfeitures are here favored rather than frowned upon. (Citations).

“Reading the lease under consideration in the light of the foregoing special rules of construction, we are of the opinion that, while it does not conform to any of the known forms of oil and gas leases and does contain the phrases ‘grant, demise, lease and let’ and ‘covenant and agree,’ *it in fact goes no further than to grant to lessee the privilege of drilling or not drilling at its option and requires the lessee to do nothing, and, if drilling is commenced, the lessee is required to prosecute such operations to completion with diligence. In all essential features this lease is analogous to the one under consideration in McDaniels v. Hager-Stevenson Oil Co., above. It is true that it does not contain the clause ‘unless’ the lessee pay rent, but it does provide that the lease shall be null and void unless the lessee sees fit to commence operations within the time limit and continue those operations with diligence until gas or oil is discovered in paying quantities or the required depth is reached, and does not require the lessee to do either of these things. It falls, then, within the category of the ‘unless’ form of lease, which terminates ipso facto on failure to exercise the option granted and under which no affirmative action is required of the lessor. It is therefore immaterial that the lessor took no action to declare*

a forfeiture before bringing his action, as the lease automatically expired long prior to the commencement of the action. Solberg v. Sunburst Oil & Gas Co., 76 Mont. 354, 246 P. 168."

The decision in *Empire Gas and Fuel Company v. Saunders*, 22 F. 2d 733 (C.C.A. 5) states at page 735:

"The lease under consideration provides that, if drilling is not begun within one year from its date, the rights of the lessee shall terminate, unless the lessee keeps it alive by making the payments of rent. It makes time the essence of the contract. The lessee is not obligated to do anything, but, if it fails either to drill wells or to make the payments of rent as and when due, its rights and privileges are at an end. The lessor was under no duty to notify the lessee of a failure to pay the correct amount due as rent, and had the right to remain silent. Under these circumstances, the lessee could not rely on the lessor's silence."

See also *Clovis v. Carson Oil & Gas Co.*, 11 F. Sup. 797 (D.C.E.D. Mich.); *McCrabb v. Moulton*, 124 F. 2d 689 (C.C.A. 8); *McDaniel v. Hager-Stevenson Oil Co.*, 243 P. 582, 585 (Mont.); *Guerra v. Chancellor*, 103 S.W. 2d 775 (Tex.); *Thompson on Real Property*, Perm. Ed., Vol. 10, Sec. 5570; *Williams v. Ware*, 31 P. 2d 567 (Okla.), holding that an unless lease is a unilateral option.

The word "unless" does not actually appear in the language of this agreement, but the word is defined in the New Century Dictionary as "if it be not . . . that", or "if . . . not." The agreement states, "If the negotiations . . . shall result in the drilling . . . *then this assignment shall be at full force and effect.*" The obvious paraphrase

is that the assignment shall not become effective *unless* the well is drilled.

As has been detailed above, an oil royalty interest of the type involved in this litigation is an interest in real property. In *Callahan v. Martin*, 43 P. (2d) 788, *supra*, the California court turned to the common law for an analogy upon which to determine the nature of an oil royalty. We believe such analogy is likewise of assistance in this case, and that the agreement between Appellant and Phebus and Stock is a typical illustration of the common law condition precedent wherein the rights of grant do not actually arise until such time as there has been a full compliance with the conditions. In the various constructions of the oil and gas agreements, which have been set forth above, there are references to this condition precedent. A definition is found in 12 C. J. 407, which reads as follows:

“Condition Precedent. (Par. 1) A. In General. One which is to be performed before some right dependent thereon is performed; one which must be performed before the interest affected by it can vest; one that must happen before the estate dependent upon it can arise or be enlarged; one that must happen or be performed before the estate can vest or be enlarged. In contracts, a condition which calls for the performance of some act or the happening of some event after the terms of the contract have been agreed upon, before the contract shall take effect; that is to say, the contract is made in form, but does not become operative as a contract until some future specified act is performed, or some subsequent event occurs. It seems to be agreed that in regard to all condi-

tions whether in a deed or will or in simple contracts, where the condition is in the nature of a consideration for the concession, its performance will be regarded as intended to precede the vesting of any right, and so a condition precedent. A condition precedent implies an existing fact, or state of facts, which must be so changed as to bring it into a condition desired. *A condition which involves anything in the nature of a consideration is, in general, a condition precedent.*"

We may cite two additional cases which deal in general with the type of agreement of concern and characterize the performance of the drilling as a condition precedent. Thus in *Ellison v. Skelly Oil Co.*, 244 P. (2d) 832, (Okla.), the Court states at page 836:

"In *Gillespie v. Bobo*, 271 F. 641, 644, concerning an 'unless' lease there involved, the Federal Fifth Circuit Court said: 'Such instruments as the one in question have been passed on frequently by the courts of Texas. It is well settled by the decisions of those courts that such an instrument confers on the so-called lessee a privilege for the specified time, with the option to secure the extension of the privilege for an additional period upon complying with the prescribed condition, and that time is of the essence of such a provision as the one above set out. *Ford v. Barton* (Tex. Civ. App.) 224 S.W. 268; *Bailey v. Williams* (Tex. Civ. App.) 223 S.W. 311; *Young v. Jones* (Tex. Civ. App.) 222 S.W. 691; *Ford v. Cochran* (Tex. Civ. App.) 223 S.W. 1041. The equitable rule as to relieving against forfeitures has no application to the case of a failure of a holder of an option to do, within the time fixed, what is required to acquire the thing which is the subject of the option. *Equity does not undertake*

to dispense with compliance with what is made a condition precedent to the acquisition of a right. (citing authorities)"

Again in *Williams v. Ware*, 31 P. (2d) 567, at page 569:

"Quoting from the case of *Brennan v. Hunter*, 68 Okl. 112, 172 P. 49, which is referred to by this court with approval in the case of *Garfield Oil Company v. Champlin*, 78 Okl. 91, 189 P. 514, 520, the court said:

"The lease in the instant case explains fully the nature and extent of the interest passed to the lessee; that is, the lessor grants, demises, leases, and lets unto the lessee for the sole and only purpose of mining and operating for oil and gas and of laying pipe lines and of building tanks, towers, stations, and structures thereon to produce, save, and take care of said products. The lease by its express terms would terminate unless a well was completed on the land on or before August 23, 1916. The rental provision granted an option to the lessee; that is, that by the payment of the rentals the time for completing the well would be extended another six months. It is immaterial whether that provision be regarded as an option to renew the lease, or extend the terms, or to continue the lease in force, or defer completion of a well, or to extend the time for performance of the condition to complete a well. *The payment of the rentals specified on or before August 23, 1916, was a condition precedent to such renewal extension, or continuance of the lease, or deferring completion, or extension of the time to perform the condition to complete a well.* When the option was not exercised, the lease, according to its express terms, terminated on August 23, 1916, be-

cause no well was completed on or before that date. The lessee did not agree to pay said sum, and this cannot be called a case of forfeiture incurred for breach of a covenant to pay money, or any other covenant. Up to the 23rd of August, 1916, the lease was unilateral to this extent: The lessee could pay or not pay the rentals, and, if he did not pay, he would not be liable to the lessor for the same. When the lessee failed to exercise the option to extend the time, the situation became the same as though no provision for extending the time had been incorporated in the lease. The defendant, failing to exercise its option or privilege, its rights are governed solely by the clause providing that the lease should remain in force for a term of five years from date, and if no well was completed on said land on or before the 23rd of August, 1916, the lease would terminate as to both parties. It has been held by a long line of decisions of this court that an "unless" lease, such as is here involved, is a unilateral option.' "

The analogy to the common law condition precedent is obvious. The language states that IF a well is drilled in accordance with the specifications of the agreement, both as to time and the Company to perform the drilling, "then this assignment shall be at full force and effect as to the oil royalties hereinafter set forth." This clearly can mean only that there was no interest which could vest in Phebus and Stock until this well was drilled as contemplated. Any other construction necessarily ignores the plain language of the agreement and the obvious intent of the parties in this regard. The language ties directly with the common law definition of a condition precedent, which is simply a condition to be per-

formed before a right dependent thereon is acquired, or the estate dependent upon it can arise or be enlarged. A further test of the intent of the parties is found in the fact that at no time has Appellant acquired any right of action whatsoever for damages or injury in the event the well was not drilled. This is a typical condition precedent as conceived by the common law, and under such conception failure to perform the condition has the effect of preventing any interest from vesting. This is obviously what transpired in the instant case.

C. Claim based on agreement has been abandoned.

As the above citations have indicated, the Courts have uniformly expressed a concern with the necessity of so construing oil agreements as to expedite drilling and development of the resources of the various states. The agreement contemplates two wells, one on the Rangely structure, and the other on this property on the Ashley Valley structure. The first, and Rangely deep test well, was completed on July 31, 1933, and the time limitations of Exhibit C required the commencement of drilling on the Ashley Valley structure on January 31, 1934. This well was not drilled. The agreements which had been executed with Standard Oil and its subsidiary, The California Company, were by the latter reassigned on March 21, 1943, (Exhibit H), with a recital that the California Company "had elected not to commence the drilling of a test well on the Ashley Valley structure." From that date, for year after year, the land was vacant and there was no oil drilling of any kind by any Company until the year 1948, when Equity Oil Company spudded

in its well. This is a period of fourteen years, which is scarcely the activity contemplated, and for which these royalty holders were willing to relinquish one-third of their royalties. The background compels the conclusion that time was of the essence. Gas was being produced in 1930 and oil had been discovered on the premises prior to that time according to the testimony of appellant. This simply means that although there had never been commercial production of oil, there was every indication to believe that oil would in fact be found. To secure that development within a relatively short period of time appellant was willing to forego a one-third royalty, and there is no other premise upon which there is any explanation for the meticulous detail of the condition which was inserted in this agreement.

The conclusion is obvious and the fact of abandonment clear from this record. Not only did Phebus and Stock fail to perform the condition set forth in the agreement, but both themselves and the other respondents herein knew that such condition had not been performed. The agreement was abandoned in its entirety following January, 1934.

Abandonment is well known in oil and gas law. As the Court stated in *Rehard v. Klossner*, 119 P. (2d) 145, pages 147, 148:

“The trial court found that there had been no drilling on the leased lands for more than two years and that defendant had failed to pay the rentals. These findings show an abandonment of the lease and the leased property sufficient to support the judgment.

“In the case of Hall v. Augur, 82 Cal. App. 594, 256 P. 232, 234, the oil lease in question there was dated May 5, 1921, and became effective not later than May 30, 1921. There was no forfeiture clause in the lease. The suit to quiet title against it was filed on May 22, 1922, as no drilling operations had been started. In holding that there had been an abandonment, the court said:

“ ‘Abandonment will be more readily found in the case of oil and gas leases than in most other cases. In Harris v. Riggs, 63 Ind. App. 201, 112 N.E. 36, it is said: “Such a lease may be abandoned, and when once abandoned by the lessee, he cannot thereafter claim or enforce any right thereunder without first securing the consent of the lessor or a renewal of the lease. (Citing authorities)

“ “It has been held and supported by sound reason that abandonment may be more readily found in cases of oil and gas leases than in most other instances. The rights granted under such leases are for exploration and development. The title or interest granted is inchoate until oil or gas is found in quantities warranting operation, and courts will not permit the lessee to fail in development and hold the lease for speculative or other purposes, except in strict compliance with his contract for a valuable and sufficient consideration other than such development. (Citing authorities)”

“ “We believe the evidence was sufficient to support the finding of fact by the trial court that the defendants abandoned whatever right, title, or interest they or either of them, had in and to such lease prior to the assignment of said lease to the Interstate Oil Corporation.’ (Citations)”

- D. The statute of limitations did not constitute a defense, because such statute does not apply to an action in the nature of quiet title to remove a cloud, and the action could not in any event arise until November, 1948, one year and six months prior to time action was commenced on May 16, 1950.**

In the first place, the Court has misconstrued the clear intent of the parties as expressed in Exhibit C. As we have pointed out in detail above, no right was vested in Phebus or Stock until such time as they had performed this condition, and since it was never performed, no right under this Exhibit ever matured. None of the affirmative defenses asserted by respondents have any application, and this is true of the one defense upon which the Trial Court apparently based its decision, which was the statute of limitations.

Paragraph 3 of the Conclusions of Law, (R. 41), states that appellant's cause of action accrued on or about January 1, 1934, which was six months after the completion of the deep test well on the Rangely structure in Colorado, which had been completed on July 1, 1933.

Paragraph 4 of such Conclusions, (R. 41), then goes on to find that the action is one upon a contract or obligation founded upon an instrument in writing, and was, therefore, barred within six years from the date of the accrual of the cause of action under the provisions of the Utah statute of limitations set forth in Title 78, Chapter 12, Section 23, subsection 2. In these Conclusions of Law it is apparent that the Trial Court has not only misconstrued the essential nature of this action, which is to

remove a cloud and quiet title, but it has likewise failed to properly establish the time at which a cause of action arose.

This action did not arise, and appellant was not required to take any affirmative action, until such time as he was aware that an adverse claim existed. It is clear from the record that appellant had no conception of the fact that there was a claim to his one-third of one percent royalty interest until he first saw the endorsement on the royalty check received from Equity Oil Company in November, 1948. His actions are consistent with such belief, and, in fact, at this time he was not sure that such a claim existed, but felt the necessity of attempting to determine such fact because of the unusual wording of the endorsement on the royalty check. He immediately attempted to contact Stock, discussed the matter with Phebus and finally wrote a letter to Stock requesting clarification and a determination as to whether or not, in fact, there was an adverse claim. Prior to the receipt of such check from Equity Oil Company his entire conduct indicated that he had no idea of any claim existing after the year 1934 and the failure of performance of the condition contained in Exhibit C.

The Court, moreover, has failed to properly analyze the action as one to remove cloud and quiet title. In such event, the statute of limitations does not apply as the cloud is deemed to exist at all times until it is, in fact, removed either by voluntary action of a party or court decree. In this connection we should point out that all of the cases hereinabove cited which analyze and deal with

the "unless" type of agreement are basically actions to quiet title.

In the case of *Hudson v. Smith*, 41 P. (2d) 861, (Okla.), the court states:

"We know of no statute in this state that bars the plaintiff's action. The defendants claim that since the deed was executed in 1919, and suit not commenced until 1933, the action is barred. *The statute could not commence to run until plaintiff became aware of a hostile claim, or a dispute as to his interest.* The petition alleges that no hostile claim arose until less than one year prior to the commencement of the action. *The plaintiff's right to an equitable adjudication of his title was a continuing one, and no statute of limitations could commence running until an adverse claim arose.* *Robertson v. Battles*, 97 Okl. 54, 221 P. 1002." (page 864)

In *Luker v. Anderson*, 10 S.W. (2d) 149, the Court stated at page 150:

"The contention of appellant that appellee's cause of action was barred by the statute of limitations must be overruled. *The injury from a cloud on title is continuing, and the cause of action for its removal is likewise continuing and never barred while the cloud exists.* *Texas Co. v. Davis*, 113 Tex. 321, 254 S.W. 304, 255 S.W. 601."

See 17 *R.C.L.* 715, paragraph 71, page 715:

"Action to quiet title — A cloud upon a title is considered as continuing to operate during the period of its existence and, therefore, the right to maintain an action to remove a cloud from a title is a continuing one to which the statute of limitations is not applicable."

Skelly Oil Co. v. Wickham, 202 F. (2d) 442
C.C.A. 10);

Superior Oil Co. v. Jackson, 250 P. (2d) 23
(Okla.);

Mark v. Bradford, 23 N.W. (2d) 205, (Mich.)

In this connection also we direct the Court's attention to paragraph 2 of the Conclusions of Law, (R 41), wherein the Court holds that plaintiff's action, if any, is in personam, and apparently ties this to its conclusion relative to the statute of limitations. What has been said above would apply both to an action in personam or an action in rem. We believe, however, that this is a fundamental error on the part of the Court. This would seem to imply that the Court viewed the conditions and limitations of Exhibit C as a specie of covenant rather than as a condition. A covenant is well known in law, and must necessarily involve an agreement to do or refrain from doing an act. A condition, on the other hand, is simply an event which may occur and as the result of which a legal right is lost or acquired. Under Exhibit C there was no requirement that Preas or Phebus drill or not drill. They were free to do as they desired, and clearly this is not a covenant. On the other hand, it is a typical condition, in that if Standard Oil Company, or its subsidiary, drilled a well on the property within the limited time specified, then and only then respondents would have acquired the right in question.

POINT III. THAT THE TRIAL COURT ERRED IN MAKING AND ENTERING ITS FINDINGS OF FACT, THE SAME BEING CONTRARY TO THE EVIDENCE AND STIPULATED FACTS.

Two particular Findings of Fact indicate that the Court has misconstrued the evidence. Paragraph 4 of such Findings, (R. 39), reads as follows:

“That on October 11, 1930 the plaintiff, for a valuable consideration, assigned, conveyed and set over unto the defendants Paul Stock and Ray Phebus one-third of all his right, title and interest in and to said oil royalty interest, except as the same pertains to the NE $\frac{1}{4}$ of the SE $\frac{1}{4}$ of said Section 15, with the express understanding and agreement that the said Stock and Phebus would reconvey the royalty interest so assigned to them in the event that Stock and Phebus did not procure the drilling of a test well on the above described property, the so-called Ashley Valley structure, by the Standard Oil Company of California, or by some other operator, within six months after the completion of a deep test well to be first drilled, but not later than the summer of 1931, on the Rangely structure in Northwestern Colorado, all as provided by the written assignment, copy of which is attached to plaintiff's amended complaint as Exhibit 'C'.”

It is apparent from this Finding that the Trial Judge has misconstrued Exhibit C and the resulting effect of the failure of performance of the conditions contained therein. It recites that this instrument was made for a valuable consideration, whereas, in fact, the only consideration is the actual drilling of a well as contemplated by the agreement, and the Finding fails to recognize that the instrument in question is in net effect unilateral and nothing more than an option, as has been pointed out hereinbefore.

Finding of Fact No. 6 reads as follows: (R. 40)

“That by mesne conveyances and assignment the defendants Paul Stock, Joe T. Juhan and Weber Oil Company have succeeded to and are now the record holders and owners of said one third of one percent oil royalty interest.”

It is obvious that since no rights vested under Exhibit C there never existed any basis upon which Phebus or Stock could have later made effective conveyances to the present respondents. It is interesting to note that there is no instrument subsequent to the time of their failure to perform the condition of well drilling in January 1934, which makes any specific reference to Exhibit C. The importance of these Findings lies in the fact that they show clearly the basic error of the Trial Judge in analyzing Exhibit C, and are factual findings upon which the two Conclusions of Law considered above have presumably been based.

POINT IV. THAT THE TRIAL COURT ERRED IN REFUSING APPELLANT'S TENDER OF PROOF THAT APPELLANT DID NOT RECEIVE \$1.00, WITH REFERENCE TO THE EXECUTION OF THE AGREEMENT BETWEEN APPELLANT AND PHEBUS AND STOCK, FROM WHICH ANY RIGHT OF RESPONDENTS MUST ORIGINATE.

At page 16 of the Transcript (R. 45), appellant, with reference to whether or not he had received the \$1.00 referred to in the first paragraph of the body of Exhibit C, made tender of fact as follows:

“And in connection with that, I would like to make a formal tender of proof in the record, that Mr. Preas was in the court room and would answer and testify that in fact he did not receive the \$1.00.”

It is perfectly obvious that this fact has a direct bearing on the issues of this case. One of the keys to a determination of such issues lies in establishing the intent of the parties to this agreement. The fact that this sum was never paid is a strong indication that none of the parties viewed it as having any relation to the real consideration of the agreement, and the tender is clearly relevant to this point and should have been admitted in evidence.

CONCLUSION

In conclusion appellant asserts that the judgment of the Trial Court is in error as it fails to recognize that any right of respondents in and to the one-third of one per cent oil royalty must necessarily arise from Exhibit C, and no rights in respondents could have vested under such Exhibit until there had been a performance of conditions set forth therein. Such performance was precedent to any such right, and when Phebus and Stock failed to perform such conditions within the time limitation set forth, expiring in January, 1934, their right, title and interest to any claim under this agreement had expired. Thereafter appellant was not required to take any affirmative action of any kind, nor to demand a re-conveyance from Phebus and Stock. Further, that the statute of limitations which forms the basis of the Trial Court's judgment is not applicable because such statute does not apply to this action which is a quiet title action to remove a cloud, and because, in any event, no adverse claim arose until the year 1948, which was less than two years from the date of commencement of the instant case.

Appellant, therefore, respectfully prays that the judgment of the Trial Court be reversed and a decree entered establishing appellant's right and title in and to the one-third of one per cent royalty here involved, and requiring respondent Equity Oil Company to forthwith pay to appellant royalty proceeds based upon such one-third of one per cent interest from November, 1948, to date hereof.

Respectfully submitted,

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