1984

# Flying Diamond Oil Corporation, Formerly Known as Flying Diamond Corporation, a Utah Corporation v. Newton Sheep Company, a Limited Partnership; Ralph M. Newton, Eugene B. Newton And Scott F. Newton, General Partners; And Eugene B. Newton, Individually, And Edna Elliott Newton, His Wife : Reply Brief of Appellant Flying Diamond

IN THE SUPREME COURT OF THE STATE OF UTAH

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| FLYING DIAMOND OIL CORPORATION, formerly known as FLYING DIAMOND CORPORATION, a Utah corporation, | : | |
| Plaintiff-Appellant, | : | |
| vs. | : | |
| NEWTON SHEEP COMPANY, a limited partnership; RALPH M. NEWTON, EUGENE B. NEWTON and SCOTT F. NEWTON, general partners; and EUGENE B. NEWTON, individually, and EDNA ELLIOTT NEWTON, his wife, | : | Case No. 19178 |
| Defendants-Respondents. | : | |
| and | : | |
| BASS ENTERPRISES PRODUCTION CO., a Texas corporation, | : | |
| Intervenor Defendant-Respondent. | : | |

# REPLY BRIEF OF APPELLANT FLYING DIAMOND

APPEAL FROM THE JUDGMENT OF THE THIRD JUDICIAL DISTRICT COURT OF SUMMIT COUNTY, STATE OF UTAH, HONORABLE ERNEST F. BALDWIN, JR., DISTRICT JUDGE.


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REPLY BRIEF OF APPELLANT FLYING DIAMOND

Appellant Flying Diamond submits this brief in reply to the response briefs of respondents Bass and Newton. Neither of those briefs follows the format of the appeal brief, nor the format of the other. For clarity, this reply is organized in terms of the seven points initially raised, and respondents' arguments are replied to in that context.

## FACTUAL STATEMENTS

The statement of facts in Flying Diamond's brief was neither agreed to nor specifically controverted by either respondent, as required by the applicable rule (Utah R. Civ. P. 75(p)(2)); each submitted a statement that can fairly be criticized as conclusionary and selective.

The Bass statement contains two serious factual errors requiring correction:

(1) Bass's purported quotation of Section 7 of the Surface Owner's Agreement (Bass brief, p. 3) is incorrect. Without indication of an omission, the quotation as it there appears omits language bearing directly upon the basic problem of the lawsuit. The actual language of Section 7 is copied below, the language Bass omitted being underlined:

> Subject to the provisions of Section 9 hereof, it is agreed that the covenants to pay the sums provided in Sections 2, 3, and 5 hereof shall be covenants running with the surface ownership of the described premises and shall not be held or transferred separately therefrom, and any sums payable under this agreement shall be paid to the person or persons owning the surface of the described premises as of the date the oil or gas or associated liquid hydrocarbon production is marketed. Champlin shall not, however, become obligated to make such payments to any subsequent purchaser of the described premises and shall continue to make such payments to the Land Owner until the first day of the month following the receipt by Champlin of notice of change of ownership, consisting of the original or certified copies of the instrument or instruments constituting a complete chain of title from the Land Owner to the party claiming such ownership, and then only as to payments thereafter made.

(R 480-81).

(2) Bass's brief (p. 6) states that "[n]o objection was made to the receipt of evidence regarding the Newton's deed or the Ranch Purchase Contract." In fact, all parties agreed in the Pretrial Order that Flying Diamond had such an objection (Pretrial Order: IV, para. 4, R 280; VI, R 282) Flying Diamond re-stated the objection to this extrinsic evidence at the outset of the trial (R 526, Tr 10). By way of expedition of the nonjury trial, the judge received the extrinsic proof on the following basis, understood by all parties (R 526, Tr 10):

> THE COURT: All right. That gives me a little question there. As I read I was wondering if it might not be helpful for the purpose of -- I know you believe it's a matter of law and you say you have some testimony. What if we were to let them put on their witnesses, extrinsic testimony, and then as I go through taking your theory, if I think I need the extrinsic testimony I will refer to it. If not I will ignore it. If I take your theory --

A conspicuous omission characterizes the briefs of both respondents. The Bass brief omits mention of Section 4 of the Surface Owner's Agreement; the Newton brief purportedly summarizes Section 4 (Newton brief, p. 5) but omits any reference to the important language: "Nothing herein contained shall be construed . . . as a grant to Land Owner of oil or gas rights or rights in other associated liquid hydrocarbons." (R 480). The provision bears directly upon the legal nature of the 2 1/2% easement payment covenant.

## REPLY ARGUMENT

POINT I. The 2 1/2% easement payment covenant, and the payments, are inseparable from the surface ownership as a matter of law.

The theory of the point stated in the caption is that Champlin's covenant to make the 2 1/2% payments is a covenant running with the surface ownership. Its legal attributes are determined by the rules of real property law and not contract law. The effect of such rules is that the benefits of the covenant are inseparable from the surface ownership, so that the separate fractional transfer of covenant benefits which Bass and the Newtons say they attempted is precluded as a matter of law.

Flying Diamond's Point I also demonstrated, alternatively, that, were the covenant to be treated as personal and not real, the legal consequences under contract law would be identical.

Replies to the Bass and the Newton arguments about these basic points are set out below.

### I.(a) Covenant Running With the Land.

The Surface Owner's Agreement was made against the background of the potential for dispute inherent in the severance of the surface estate from the oil and gas estate and the pre-existing legal relation between the parties. These factors, discussed in detail in the appeal brief (pp. 11-14) show the reasons for the inseparability provisions. This discussion was not challenged by either respondent. Neither of

them directly challenged the point that real property law governs the case.

The authorities that are cited in the appeal brief to show that the 2 1/2% easement payment covenant is a running covenant are not repeated here. An additional case, Carlson v. Lindauer, 119 Cal. App. 2d 292, 259 P.2d 925 (1953), is directly in point and construes an agreement which is essentially identical to the Surface Owner's Agreement. In Lindauer, the agreement was between Union Oil, the owner of the oil and gas estate in described lands, and the surface owners of the lands, who granted surface easements to Union in consideration of Union's covenant to pay the owners 10% of the value of the oil and gas and 40% of the net value of the gasoline produced. The agreement provided that "[t]he right to receive [such] payments . . . shall be and remain inseparable from the ownership of such lands." The agreement also provided that, after testing the ground, Union could drop individual parcels from its project and, with respect to a parcel so excluded, Union covenanted to quitclaim the oil and gas title to the "Owner or Owners" thereof, subject to Union's retained surface rights of way. Union elected to exclude the subject lands, and then made and recorded the deed quitclaiming the oil and gas title that was at issue in the case. That oil and gas title was disputed as between the successor surface owners (the plaintiffs) and the subsequent devisees (the defendants) of Lucy Lindauer, the "Owner" named in the deed. The case holds:

(1) Union's quitclaim covenant was a covenant running with the surface ownership, and its benefit ran to the successor surface owner as such. Title to the oil and gas was accordingly quieted in plaintiffs. While the agreement expressly stated the inseparability of the payment covenants from the surface ownership, it did not contain a similar express statement as to the quitclaim covenant. Nevertheless, the court determined that all elements of a running covenant were present and that the quitclaim covenant could not be separated from the surface title. The case is a square holding that the elements of touch and concern, privity, and intent are present in circumstances identical to those of the present case.

(2) The grantee named in the quitclaim deed was "Lucy Lindauer hereinafter referred to as 'Owner,' whether one or more, Second Party." This grant was held to run to the successor surface owners, not Lucy Lindauer's heirs. The similarity of the term "Owner" to the term "Land Owner" as used in the Surface Owner's Agreement is apparent.

It should be noted that the Lindauer opinion refers to the payment covenant in the case (10%, and 40% of net) as "royalty." The covenant was not in issue, and the reference is an aside. The court used the term in its comment that the Union agreement carved out and granted an incorporeal hereditament and an interest in land. 259 P.2d at 931. In this respect the Union agreement differs from the Surface

Owner's Agreement, which in Section 4 expressly provides that the Agreement does not grant oil or gas rights. (R 480).

The brief filed by Bass does not address the basic legal problem of covenants running with the surface ownership, nor does it question the proposition that, if the 2 1/2% covenant is held to run, it follows that its benefits are inseparable from the surface ownership.

Similarly, the Newton brief does not dispute the point that if the covenant runs its benefits cannot be separated from the surface ownership. Point I of the Newton Brief asserts that the 2 1/2% covenant does not run, and that none of the elements of touch and concern, privity, or intent, is present. (Newton brief, pp. 10-23).

Touch and concern. The Newton argument (p. 12) appears to be that the 2 1/2% payments under Section 2 "need not be used on the land to improve it, but may be used in any way the landowner wants." This is contrasted with the damage payments due under Section 5, which are apparently considered directly related to the land. The claimed conclusion is that the 2 1/2% payment covenant is merely personal.

The reasoning is unclear. All three payment covenants are identical in nature, in that each compensates for an adverse impact upon the surface owner's enjoyment of his surface title; the inseparability language of the Surface Owner's Agreement is common to them all, and accords identical attributes to all; all of the covenants require payments to the

person owning the surface at the time, in the same way. The claimed distinction is not there.

A list of cases is cited in the Newton brief (pp. 14-20) in support of the Newton claim that the 2 1/2% covenant does not touch and concern the surface ownership. Examination shows that not one supports the position taken. The cited cases are: H.T. & C. Co. v. Whitehouse, 47 Utah 323, 154 P. 950 (1916), is not a touch and concern case; it involves privity (the privity holding, discussed below, supports the Flying Diamond position); City of Tucson v. Superior Court, 116 Ariz. 322, 569 P.2d 264 (Ct. App. 1977), is not a touch and concern case; it involves failure to satisfy the statute of frauds; Choisser v. Eyman, 22 Ariz. App. 587, 529 P.2d 741 (1974), in which the court held that where the parties clearly intend to create only a personal right enforceable by the original covenantee, the parties negate any intent that the covenant touch and concern the land; Choisser is cited in 5 R. Powell, The Law of Real Property, ¶ 673[2], at p. 60-41 & n.27 (1981) as a court's acceptance of Dean Bigelow's proposed touch-and-concern test (quoted in the appeal brief at p. 20); Johnson v. State, 27 Or. App. 581, 556 P.2d 724 (1976), is not touch and concern case; according to Powell (supra, ¶ 673[2], pp. 60-44 & 60-45), the case involves the problem whether the burden can run when the benefit is personal, an issue not involved where, as here, the question is as to the running of the benefit; California Packing Corp. v. Grove, 57 Cal. App.

153, 196 P. 891 (1921) is obviously distinguishable on its facts and also involved the running of a burden; the court held that a duty to sell peaches was personal and did not run; Colonia Verde Homeowners Ass'n v. Kaufman, 122 Ariz. 574, 596 P.2d 712 (Ct. App. 1979) is not a touch and concern case.

Some Utah cases are cited by the Newtons. The holdings and the reasoning of the Utah cases supply further support for the Flying Diamond position that the 2 1/2% covenant runs. Van Cott v. Jacklin, 63 Utah 412, 226 P. 460 (1924) holds that the covenants of warranty and quiet enjoyment run with the land and are enforceable by a subsequent grantee in accordance with their terms, notwithstanding his actual knowledge of the boundary problem warranted against. Ruffinengo v. Miller, 579 P.2d 342 (Utah 1978) enforces a restrictive covenant in subdivision lands. Two cases, Latses v. Nick Floor Inc., 99 Utah 214, 104 P.2d 619 (1940) and Lundeberg v. Dastrup, 28 Utah 2d 28, 497 P.2d 648 (1972) hold that a covenant to pay the obligation of another (legal fees) is personal and does not run. The touch and concern test stated in Lundeberg is that in order for a covenant to run the covenant must "be of such character that its performance or nonperformance will so affect the use, value or enjoyment of the land itself that it must be regarded as an integral part of the property."

This test is clearly met by the 2 1/2% easement payment covenant. Champlin's remittances on account of the

covenant (and its obligation to continue them for the duration of the oil and gas project) affect the surface owner's use, value and enjoyment of the surface in a fundamental way. The recurring payments compensate on a continuing basis for the burdens imposed by the continuing use of the surface easement, in appropriate amounts, at the times the burdens are imposed, and to the owner of the surface estate so imposed upon.

Privity. The Newton brief (pp. 20-21) makes the assertion, not supported by any case, that the privity element is missing. No response is made to the demonstration in the appeal brief (p. 21) that, by any of the various tests, privity is present here. A Utah case touching the subject is H.T. & C. Co. v. Whitehouse, 47 Utah 323, 154 P. 950 (1916), in which a wife, having no title or interest in the land, joined as an accomodation in a warranty deed (with running covenants) made by her husband. The Court held that because the wife had no estate in the land she had no privity of estate with the grantee's grantee, and the covenant burden did not run as against her. However, the Court indicated that either a "mutual" or "successive" relationship in the property is sufficient for privity. (These are, respectively, the "mutual" privity and "vertical" privity appearing in Powell's formulation summarized in the appeal brief (p. 21)). Both kinds of privity are present here. The grant of surface easement in consideration of the surface payment covenants supplies mutuality of estate in the same land. Successive

privity results from Flying Diamond's purchase of the surface title, which constitutes its succession to the burdened surface and the compensating covenant payment benefits.

Intent. The Newtons argue (pp. 21-23) that the intent element of a running covenant is lacking. In view of the literal statement in the Surface Owner's Agreement that the 2 1/2% covenant is one of the "covenants running with the surface ownership," (R 290), and the fact that the agreement then spells out in specific terms the legal attributes of a running covenant, the contention is not persuasive. There was no such express statement in either of the two cited Utah cases, First Western Fidelity v. Gibbons and Reed Co., 27 Utah 2d 1, 492 P.2d 132 (1971) and Metropolitan Investment Co. v. Sine, 14 Utah 2d 36, 376 P.2d 940 (1962). In those cases, the Court considered extrinsic facts only because of the ambiguity of the covenants. First Western, 27 Utah 2d at 5, 492 P.2d at 134; Sine, 14 Utah 2d at 43, 396 P.2d at 945. In the Sine case, extrinsic facts showed the requisite intent; the facts in First Western showed a lack of such intent.

One argument advanced in the Newton brief (p. 22) in an effort to show lack of intent is based upon an incorrect summary of the testimony of Champlin's land manager. The testimony there imputed to him is (in Newton's words) that "Champlin had no interest and wouldn't care what happened so far as an assignment between the surface owner and a third person as to the proceeds of the Champlin payment." That is

not what the witness said. His statement was that it would not matter to Champlin if a surface owner made an agreement to share the payments with another after payments were made to the surface owner by Champlin (R 528, Deposition of Lagerstrom, pp. 30, 55-56). That is a wholly different idea. The witness also said (under Bass's cross examination) that he remembered instances when Union Pacific "simply made it clear that they did not recognize retention of rights separate from surface ownership." (R 528, Deposition of Lagerstrom, pp. 25-26).

I.(b) Contract Law Principles

The appeal brief (pp. 23-24) showed, on the basis of rules stated in the Restatement (Second) of Contracts, §§ 317 and 320 (1981), that even if the covenant were merely personal and contract law were applicable, no rights in the covenant or covenant proceeds were transferred to Bass. An assignment of the benefit, in the severed manner here claimed, is precluded by the Agreement. See id. § 317(2)(c). Such an assignment would materially reduce the Agreement's value to Champlin. See id., § 317(2)(a). Even if not so precluded, assignment could not transfer future rights to Bass free of the condition that the payments cease when the assignor's surface ownership ceases (See id. § 320, Comment c.).

The Bass brief argues (pp. 9-10, Point I.A.) that a share in the proceeds of the covenant is "inherently" assignable. It is so argued on the reasoning that the Surface Owner's Agreement granted a "share of the production of

minerals," which is a "royalty" and thus assignable; that a royalty is "in the nature of common law rent," hence assignable; that being payable in money it is "assignable because the right to money or future money is assignable."

The reasoning begins from the incorrect premise that the covenant grants a share of the production of minerals and is thus a royalty. Section 4 of the Surface Owner's Agreement expressly negatives the premise. See R 480. Analysis of the problem whether the covenant benefit is or is not assignable should begin with the applicable provisions of the instrument creating the covenant. These clearly spell out a specially limited kind of assignability. As the Surface Owner's Agreement provides, the covenant benefit is transferrable, but only in the manner agreed, and only to a transferee having agreed-upon status. Here, the purported transfer failed to satisfy these requirements.

Bass claims (pp. 10-11, Point I.B.) that the covenant proceeds can be separated from the surface ownership, and cites Western Union Telegraph Co. v. Shepard, 169 N.Y. 170, 62 N.E. 154 (1901) as a holding to that effect. The case is clearly distinguishable. The case involved an office building in front of which an elevated railway was constructed. This gave rise to a claim for the railway's damage to the easements appurtenant to the building. Pending adjudication, the owner (Western Union) sold the building and its easements, discounting the purchase price for the railway damage and

specifically reserving the right to the proceeds of the damage claim. The successor to the buyer, who took with knowledge, was held to be bound by the reservation of the claim. The case holds that an accrued cause of action for trespass can be reserved or assigned. The case has nothing to do with the inseparability of the benefit of a running covenant. The railway damages were not "in effect, a payment for an easement over his [the buyer's] land," as Bass claims (p. 10). The "easement" spoken of by the court was not the railway easement; the court was referring to the easements appurtenant to the building.

Point I.C. of the Bass brief asserts (p. 12) that "[t]here being no words in the Surface Owner's Agreement precluding an assignment of a share in the proceeds," such an assignment may be made. This argument fails for two reasons. First, none of the Newton/Bass testimony suggests any intention to assign a share in the proceeds, nor does their Deed. Second, the Surface Owner's Agreement does preclude the "share in the proceeds" theory. Section 10 permits transfer only subject to all the inseparability provisions, (R 481), and these affix all covenant benefits to the surface title and vest the substantive right to covenant proceeds in that person who owns the surface when a payment becomes due. To the extent that an assignment purports to change that agreed pattern, it is explicitly precluded.

Bass's Point I.C. also asserts (pp. 11-12) that the restrictions on assignability were placed there solely for

Champlin's benefit, and do not affect the equitable rights of assignee and assignor as between themselves. The Newton brief (pp. 27-29) presents substantially the same argument.

The argument is invalid. Both respondents rely on Restatement (Second) of Contracts §322(2) (1979) for the idea that a contract term prohibiting assignment is for the obligor's benefit and does not prevent an assignee from acquiring rights as against the assignor. The text of §322(2) makes clear that the general rule there stated applies "unless a different intention is manifested," which is obviously the case here. As is stated in Comment a, which explains the rationale for §322(2): "In the absence of statute or other contrary public policy, the parties to a contract have power to limit the rights created by their agreement."

The quotation in Bass's brief (p. 13) from Martin v. National Surety Co., 300 U.S. 588, 596-99 (1937) expresses the same qualification: "'After payments have been collected and are in the hands of the' surface owner 'with notice, assignments may be heeded, at all events in equity if they will not frustrate the ends to which the prohibition was directed.'" (Emphasis added). The same qualification is apparent with respect to the other Bass citations: Stark v. National Research and Design Corp., 33 N.J. Super. 315, 110 A.2d 143 (1954); Johnston v. Landucci, 21 Cal. 2d 63, 130 P.2d 405 (1942); Portuguese-American Bank of San Francisco v. Welles, 242 U.S. 7 (1916). The quotation from 3 Williston, Law of

Contracts §422 (Bass brief, p. 14) is distinguishable on that basis, and for a further reason. The subject addressed is a contract forbidding any assignment. In contrast, the Surface Owner's Agreement does not forbid assignment; assignment is contemplated if carried out in the agreed way, and indeed is required in specified circumstances. Further, the ownership of the covenant payments, when the surface is sold, is agreed to in explicit terms. The Bass authorities are distinguishable for that reason.

Respondents argue (Bass brief, p. 11; Newton brief, pp. 27-28) that the restriction upon assignability had only the administrative purpose of affording protection for Champlin's payments in accordance with its records. Had that been the purpose, the Agreement would simply have said that upon sufficient documentation of transfer Champlin would pay the successor owner of the covenant benefit. Instead, the change-of-ownership language contemplates Champlin's payments to a successor upon proof of a chain of title to the surface ownership. (R 481). This reflects the overall substantive purpose of assuring the inseparability of covenant benefit from surface ownership.

Both respondents make a further argument claimed to free them of "semantics" and to give effect to their intentions notwithstanding the rules which preclude them under real property law and contract law. (See Bass brief, pp. 14-15, Point I.D; Newton brief, pp. 27-28). This argument, and the reply, are discussed in Point IV(c) below.

POINT II. Inseparability of covenant benefit and surface ownership is shown by practical construction.

The appeal brief detailed the instances by which all the parties, by actions, recognized the inseparability of the covenant benefit from the surface ownership, and instances by which Champlin also construed the 2 1/2% covenant to be inseparable.

The Newton brief did not address the point.

The Bass brief (p. 20) responds only with the assertion that the conveyancing of the 2 1/2% interest showed that the parties viewed the covenant proceeds as assignable. That view does not appear from what the parties did. The most that can be claimed for the conveyancing is that Newton and Bass attempted a transfer but recognized that transfer might not be possible. The quitclaiming nature of the royalty grants recognizes inseparability, and the escape clause Bass wrote into subparagraph I.B. of the Deed (R 485) (discussed in the appeal brief at p. 26) is a most practical reinforcement of that recognition.

The appeal brief failed to mention a further instance of practical construction: Champlin's land manager testified that in other instances Union Pacific had made it clear that it did not recognize separate retention of the payment interest (see R 528, Deposition of Lagerstrom, pp. 25-26).

POINT III. Extrinsic proof is not admissible.

The appeal brief advanced the argument, based on the general rule stated in Hartman v. Potter, 596 P.2d 653 (Utah 1979), that the inseparability provisions of the Surface Owner's Agreement are without ambiguity, which makes extrinsic proof inadmissible. Extrinsic proof to aid in construing the Deed and the Contract is immaterial and therefore not admissible.

Neither respondent sought to point out any ambiguity in the Surface Owner's Agreement.

Bass did not address the point of the admissibility of extrinsic evidence.

The Newton brief argues (pp. 36-38), first, that Flying Diamond "does not identify the objectionable evidence" (p. 36). The argument is not well taken. Flying Diamond has contended throughout that no extrinsic evidence was admissible.

Newton argues, secondly (p. 37), that the trial court considered no extrinsic evidence as to the Surface Owner's Agreement, and that it did not base its findings about the intent of the Deed or the Ranch Purchase Contract upon the extrinsic evidence but only upon "the conclusion clearly to be drawn by the identical wording of the Bass/Newton Deed and the Flying Diamond/Newton Ranch Contract." The argument does not advance the matter. If the trial court ignored extrinsic evidence about the Surface Owner's Agreement, its misreading of

the document is a clear legal error. As to the later conveyances, the lower court took evidence improperly and imputed an "intent" to the conveyances which is obviously contrary to their wording taken alone.

Newton argues, thirdly (p. 38), that Flying Diamond by its reliance upon extrinsic proof has waived the point. The record Flying Diamond made to save its overall objection is shown at the beginning of this brief. Flying Diamond did not adopt or use respondents' evidence. It could be no waiver of the objection that, after the trial court's general ruling that it would take respondents' evidence provisionally (R 526, Tr 10), Flying Diamond in self defense offered evidence to counter that of the respondents. Flying Diamond's proffer of evidence as to the background of the Surface Owner's Agreement was a necessary response to the ruling (in the denial of its motion for summary judgment) that the Surface Owner's Agreement is ambiguous, which became the law of the case for purposes of the trial. Such a proffer obviously does not constitute a waiver.

The authorities cited by Newton (United States v. Silvers, 374 F.2d 828 (7th Cir. 1967); United States v. Bramson, 139 F.2d 598 (2d Cir. 1943); and Jarabo v. United States, 158 F.2d 509 (1st Cir. 1946)) have no bearing where the evidence was necessarily offered in response to other evidence.

The Newtons also cite two Utah cases, First Western Fidelity v. Gibbons and Reed Co., 27 Utah 2d 1, 492 P.2d 132 (1971) and Metropolitan Investment Co. v. Sine, 14 Utah 2d 36,

376 P.2d 940 (1962). These required determination whether the covenant involved was a true covenant running with the land. Each involved the disputed factual question whether the parties intended that the covenant be a running covenant; in each, the covenant was created by an ambiguous instrument which contained no expresssion of intention. That is not the case here.

POINT IV. The 2 1/2% covenant is not a royalty and was not granted or otherwise transferred by the Deed.

The appeal brief argued that the Deed's quitclaim of "royalty" did not grant an interest in the 2 1/2% easement payment covenant, which is not a royalty.

Bass and the Newtons dispute the point on two grounds, principally their assertion (made at the trial, abandoned after the trial, now re-asserted here) that the covenant interest is indeed a "royalty" in the technical sense.

The argument has been belabored at length by all parties. It appears from the definitions of royalty quoted by the parties (appeal brief, pp. 29-30; Bass brief, p. 9; Newton brief, pp. 24-26) that because the 2 1/2% covenant is not a property right in the oil and gas it is not a royalty. Section 4 of the Surface Owner's Agreement (R 480) defeats the idea. The Newton brief (p. 16) states that the recent case of Bennion v. Utah State Board of Oil, Gas & Mining, No. 18345 (Utah November 4, 1983) implies that the terminology of royalty is not settled. While the definition is not an issue in that

case, any implication from the opinion is the opposite of what the Newton brief claims. The case involves the nature of the interest of a non-consenting fractional mineral owner before and after a forced pooling. The Court employs the term royalty in its standard sense, and this usage is re-inforced by its use of the term "statutory royalty," Bennion, slip op. at 4 (the quote marks are the Court's), to refer to the plaintiff's interest as altered by the pooling order. It is of note that the Court upheld the Board's holding that "statutory royalty" entitled the owner to take his portion of production in kind.

The more interesting argument of Bass and the Newtons is that the decision should not turn on semantics, and that because they intended the transfer to Bass of a continuing one-half of all the covenant benefits the Deed should be construed in whatever way will give effect to the intention (Bass brief, pp. 14-15; Newton brief, pp. 27-28). Both respondents speak of the transaction as an assignment and both would apply contract law principles.

These replies defeat that argument:

(a) The 2 1/2% covenant is a true running covenant. That being so, real property law governs (Restatement (Second) of Contracts & Comment b, § 316(2) (1979)) and requires reversal of the decision below as a matter of law. Debate about contract principles is wholly theoretical.

(b) As a matter of contract theory, a construction of the Deed as an "assignment" is not what respondents now seek.

The term is defined in the Restatement (Second) of Contracts § 317(1)(1979):

> An assignment of a right is a manifestation of the assignor's intention to transfer it by virtue of which the assignor's right to performance by the obligor is extinguished in whole or in part and the assignee acquires a right to such performance.

Respondents' present theory, if understood correctly, is not an "assignment." Bass does not purport to hold a direct right in future payments, so that Champlin's payment direct to Bass would discharge Champlin's obligation. Respondents say that, by the Deed, Bass acquired Newton Sheep's promise that it would make future individual successive assignments, or sharings of payments, after each individual payment from Champlin is in Newton hands. Clearly, the Deed states no such promise, nor is there any support for the idea of such a promise in the testimony of the Newton brothers. Such a promise is contrary to the testimony of Mr. Collister, who wrote the Deed (appeal brief, p. 33). As shown below, the supposed promise could not have been made effectively had the parties expressed it.

(c) If all labels be ignored and the case be taken at its best for respondents and stated generically, the idea is that the documents were meant to transfer to Bass the right to share one-half of the benefits promised by Champlin in Section 2 of the Surface Owner's Agreement, that arrangement to continue for the entire life of the Agreement. However it may be phrased, the idea is defeated by these inherent flaws:

(i) It is an agreed term of the covenant benefit, fixed by the instrument which created it, that rights therein are not capable of transfer to one who (like Bass) has no surface ownership.

(ii) It is a similarly agreed term of the covenant benefit that a beneficiary's rights therein exist only while he has ownership of the surface title. Newton Sheep could not transfer higher or more enduring rights than it had: e.g., one vested with a life estate cannot grant a fee simple; the holder of a conditional promise cannot transfer rights in the promise free of the condition. (Negotiability is the exception to this truism, but neither Bass or the Newtons have so far said that the covenant is negotiable paper.) Newton Sheep could not transfer rights good past the duration of its own rights in the benefit.

(iii) The instrument of transfer does not manifest an intention to transfer rights enduring longer than those of the transferror, or rights not capable of transfer. The Deed's stated intent is to transfer only those rights which the transferor is entitled to transfer.

## POINT V. Respondents' assignment of proceeds theory is contrary to the evidence.

Point V of the appeal brief (pp. 31-34) showed that the conveyancer who prepared the Deed intended a present grant of a real property interest in land. He further testified that

he used the term "royalty" with an awareness that it excluded any idea of "the contractual right to receive monies" (appeal brief, p. 33). That evidence is contrary to the assignment theory (on which the judgment is based) and contrary to the theory of a promise to make future assignments. The generalized expressions of the Newton brothers, quoted by Bass (pp. 4-5) and the Newtons (pp. 6-7) are to the effect that the Newtons meant a present transfer.

Neither respondent has contrived a theory which matches the evidence with the findings, or the judgment. The theory of promised future assignments, an afterthought, does not do so.

POINT VI. Estoppel by deed precludes the Bass and Newton claims.

The appeal brief cited authorities which show that estoppel by deed precludes Bass and the Newtons. In the Surface Owner's Agreement the Newton Company made the commitment for itself and its assigns that the 2 1/2% easement payment covenant cannot be held, or transferred, separately from the surface ownership. Newton and Bass would now say, to the contrary, that they have transferred, and now hold, fractions of the covenant benefit separately from the surface ownership. Estoppel by deed precludes the latter assertion.

The responses of Newton Sheep and Bass are not sufficient to avoid the estoppel:

(1) Both respondents say, in effect, that Flying Diamond must show reliance in order to invoke estoppel by deed (Bass brief, p. 20; Newton brief, p. 34). It is doubted that estoppel by deed involves reliance. This estoppel is a mechanical rule of property based on considerations of the security of land titles, and the elements and defenses usual in equitable estoppel decisions do not apply. 28 Am. Jur. 2d, Estoppel and Waiver, § 4 (1966). The authority cited by Bass (Bass brief, pp. 20-21), 28 Am. Jur. 2d, Estoppel and Waiver, § 10 (from the principle stated, it appears and we assume that Bass intended to cite § 5) is commented on below. The cases cited by Newton do not support its assertion: Ketchum Coal Co. v. Pleasant Valley Coal Co., 50 Utah 395, 168 P. 86 (1917) is not an estoppel by deed case, the claimed estoppel being equitable in nature; Arizona Central Credit Union v. Holden, 6 Ariz. App. 310, 432 P.2d 276 (1967) does not involve any kind of estoppel; the problem is bona fide purchaser status. Contrary to what Newton claims for Rogers v. Donnellan, 11 Utah 108, 39 P. 494 (1895), that case comments (favorably to Flying Diamond's claims of estoppel) that the maker of a deed of trust is estopped to deny his warranties therein, and would not be permitted to testify otherwise. Id. at 113, 39 P. at 496. The comment is a dictum. The only authority supporting respondents is 28 Am. Jur. 2d, Estoppel and Waiver, § 5 (1966), which cites a stray Ohio case, Case v. Golnar, 33 Ohio App. 389, 169 N.E. 724 (1928).

In any event, and whether reliance is or is not required to invoke estoppel by deed, ample reliance is made out here. Flying Diamond contracted to buy, and it paid for, the full surface title to the Ranch. Since its purchase, it has conducted the surface ranch operation subject to the burdens of the oil and gas operator's uses of the surface easements, and it has justifiably relied upon the agreed provisions in the Surface Owner's Agreement that the surface payments compensate the surface owner for the easement burdens.

(2) A further Newton argument (pp. 34-35) appears to be that the Ranch Purchase Contract "conveyed what Flying Diamond bargained for" and that Flying Diamond seeks by estoppel to exceed the terms of the Contract. Colman v. Butkovich, 556 P.2d 503 (Utah 1976) and Dowse v. Kammerman, 122 Utah 85, 246 P.2d 881 (1952) are cited. If it be the rule that estoppel by deed does not enlarge a grant, the rule does not operate here. Flying Diamond seeks only what it paid for and what was granted to it, a warranted "full" surface title. That title carries with it the benefit of the 2 1/2% easement payment covenant which runs with the surface ownership.

(3) Newton Sheep argues that the Surface Owners Agreement "is not a deed but a contract" (Newton brief, p. 35), so the estoppel by deed concept is not applicable. Newton's own quotation of 28 Am. Jur. 2d, Estoppel and Waiver, § 5 (1966) (Newton brief, p. 35) shows that estoppel by deed can

apply in cases of a "deed or similar instrument." The Surface Owner's Agreement is clearly the present grant of easements. The grant is sufficient to raise estoppel by deed, and the estoppel works against the Newton Company and against Newton Sheep and Bass, its privies.

POINT VII. Flying Diamond is not estopped.

The appeal brief (pp. 36-38) showed the error of the lower court's Finding No. 9 (R 428) and Conclusion No. 7 (R 429) that Flying Diamond was estopped. It was there shown that equitable estoppel is not invoked by a quitclaim transaction, and that the evidence was contrary to Finding No. 9.

The estoppel arguments of Bass (pp. 15-19) and the Newtons (pp. 29-32) are essentially similar. It is claimed that Flying Diamond "agreed to" a one-fourth interest in the covenant, which was granted to it by paragraph 6(a)(2) of the Ranch Purchase Contract (R 493-94), and equitable considerations estop Flying Diamond from claiming a greater interest. Bass says (p. 19) that Flying Diamond seeks to enjoy a benefit of the Contract (ownership of the railroad lands) and to avoid its burden (only a one-fourth interest in the proceeds of production). The Newtons say (p. 31) that "ordinarily a party (or contract purchaser) cannot claim under an instrument without affirming it."

The replies are:

(1) Both respondents rely upon incorrect recitals of the testimony on this point. Bass says (p. 16): "The testimony of Scott and Ralph Newton (Tr. 64) shows that Flying Diamond was told of the Newtons' deed to Bass and agreed to a one-fourth share of the proceeds of the 2 1/2% payment." The Newton brief says (p. 31) "Flying Diamond drafted the [ranch purchase] contract to accommodate Newton who insisted on retaining their 1/4 percent."

These statements do not reflect the actual Newton testimony, which is clear that the fractions spoken of were not fractions of 100%, but were instead fractions of the Newton ownership. Scott Newton testified that the sale to Bass was "half of our interest," and "they [Flying Diamond] would take a quarter of what was left of the half" (R 526, Tr 65). Similarly, Ralph Newton testified that Flying Diamond "wouldn't buy the property without 50 percent of our interests" (R 526, Tr 80). Another discrepancy in the Bass summary is its statement (Bass brief, pp. 5-6) that "[t]he Newtons' interest in the 2 1/2% payment was the only mineral interest of any type that the Newtons had in the railroad lands." The record is that at trial the Newton counsel noted for the record the existence of another kind of mineral claim in the railroad lands (R 526, Tr 11), and Bass's conveyancer testified that other ("Radke-type") mineral interests might be involved (R 527, Deposition of Collister, pp. 21-22; Bass brief, p. 7).

The point of all of the foregoing is that (in contrast with Newton Sheep's mineral titles in the fee lands, which were much more important to the transaction) the parties were uncertain about the nature and extent of the Newton mineral and "royalty" interests in the railroad sections, and that therefore that part of their Deed affecting those sections did not purport to make a warranted grant of one-half of 100%. It was instead a quitclaiming grant of one-half of what the Newtons might be entitled to grant. The Ranch Purchase Contract followed the pattern. Equitable estoppel does not apply, because a quitclaim will not give rise to such an estoppel. (See appeal brief, p. 37).

Bass's brief claims (p. 19) that the royalty grant to Flying Diamond was not a quitclaim (so as to obviate the estoppel) and notes that the Ranch Purchase Contract calls for "a Warranty Deed." The substance of this is that the interest to be conveyed under the Contract is there described as one-half of whatever royalty Newton Sheep is entitled to convey. A "warranted" grant of such an interest does not call the covenants of warranty into operation. One lacking any interest in the Brooklyn Bridge can safely execute a warranty deed describing all his right, title and interest in the Bridge; his grantee takes nothing and the grantor has breached no warranty. Such a deed, however labelled, is not a warranty deed.

(2) Bass's principal reliance is upon Russell v. Texas Co., 238 F.2d 636 (9th Cir. 1956), cert. denied, 354 U.S. 938 (1957). The Russell case is distinguishable, and it illustrates the difference between a correctly applied estoppel and the present situation. The property in the Russell case was deeded by the Northern Pacific to Russell's predecessor in 1918, Northern Pacific reserving all minerals. Russell acquired the grantee's title, with notice of the mineral reservation. Texaco, Northern Pacific's oil and gas lessee, conducted "extensive operations" on the property, beginning in 1952. Russell thereafter sued Texaco and Northern Pacific for a quiet title declaration that the oil and gas lease and the mineral reservation were void, Russell's theory being that the title acquired by Northern Pacific under the congressional railroad land grant was such a title as not to be susceptible to a mineral reservation by the railroad.

The decision upholds the mineral reservation and the lease. The opinion holds that as a "fundamental" a quiet title plaintiff must succeed on the strength of his own title and not the weakness of the defendant's title. 238 F.2d at 639. Russell failed because he could "assert no independent source of title" to the minerals. The court said that even had Russell's incorrect theory about Congressional intent been sound, Russell would be estopped to assert it. The court made this observation about estoppel:

> Estoppel, in the nature of an equitable concept, is designed to protect the reliances and expectations of innocent persons from detrimental devastation by those whose assent and recognition have induced those reliances and expectations.

Id. at 640. The obvious distinctions of the present case from the Russell facts are, first, that while Russell had no "independent source of title," Flying Diamond has. Flying Diamond's ownership of the benefit of the easement payment covenant vested by the warranted grant to it of the surface title in which the covenant benefit inheres. Second, on this record (and unlike Northern Pacific and Texaco in the Russell case), Bass and the Newtons can scarcely claim that their "reliances and expectations [are those] of innocent persons" which are entitled to protection from "detrimental devastation by those who by assent and recognition have induced those reliances and expectations." Exhibits 9 (R 521-22) and 20 (R 524-25) show that there was no innocence about the Bass/Newton transaction, which was made within weeks (See R 484) after both parties' awareness of Champlin's careful advice that the 2 1/2% covenant ran with the surface ownership, and that after a surface sale Newton Sheep would not receive any payments. Nor is there any innocence about the complicated effort to circumvent the advice. Further, Flying Diamond did not induce any of the Bass/Newton reliances and expectations; it had not entered the picture.

(3) Bass and the Newtons cite many cases and authorities for the proposition that, as the Newton brief puts

it (p. 31), "Flying Diamond may not by its actions both claim under the contract and at the same time claim it is not bound by its terms." The Russell case discussed above is one such case, and a list of others is cited (Newton brief, pp. 31-32; Bass brief, pp. 17-19). All are distinguishable by the basic fact that Flying Diamond seeks only to have the Ranch Purchase Contract enforced in accordance with all of its terms. No claim is made by Flying Diamond that it is not bound by any provision of the Contract.

(4) As a further basis for the claimed estoppel of Flying Diamond, the Newton brief asserts with apparent seriousness that "one is not permitted in a court of justice to take advantage of . . . his own wrong." (Newton brief, p. 32). The "wrong" assigned to Flying Diamond is that in preparing the Ranch Purchase Contract it followed the language of the earlier Deed. The brief does not further explain why this use of the prior language was wrong but that it was not so when first employed. The idea of counter estoppel, suggested by the Newton brief (p. 31), applies. The Newtons and Bass cannot be heard to call improper the very pattern they themselves set.

(5) Russell, 238 F.2d 636, holds that reliance must be shown by one who would invoke equitable estoppel. See also 28 Am. Jur. 2d, Estoppel and Waiver, §§ 35 & 76 (1966). Bass and the Newtons made their transaction long before Flying Diamond entered the scene, and neither has done anything since that time in reliance upon Flying Diamond.

## CONCLUSION

Respondents' briefs failed to meet the points raised in the appeal brief. The judgment below should be vacated.

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on the 7th day of February, 1984, I served a copy of the attached Reply Brief of Appellant Flying Diamond by mailing a copy thereof in a securely sealed, postage paid envelope to the following:

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