1983

Atlas Corporation v. National Growth Corporation, Et Al. and the Clovis National Bank and the Citizens Bank of Clovis : Reply Brief of Appellants

IN THE SUPREME COURT

OF THE STATE OF UTAH

ATLAS CORPORATION, Plaintiff-Respondent, vs. NATIONAL GROWTH CORPORATION, et al., Defendants, and THE CLOVIS NATIONAL BANK and THE CITIZENS BANK OF CLOVIS, Defendants-Appellants.	)	No. 19239

REPLY BRIEF OF APPELLANTS

Appeal from a Summary Judgment of the Seventh Judicial District Court in and for San Juan County, Utah
Honorable Boyd Bunnell, Judge

Attorneys for Defendants-Appellants

Dale A. Kimball
Stephen J. Hull
Ronald G. Russell
Rooker, Larsen, Kimball & Parr
185 South State Street
Suite 1300
Salt Lake City, Utah 84111
Telephone: (801) 532-7840

Allen C. Dewey, Jr.
Modrall, Sperling, Roehl, Harris & Sisk
P. O. Box 2168
Albuquerque, New Mexico 87103
Telephone: (505) 243-4511

Attorneys for Plaintiff-Respondent

Stephen D. Alfers
William A. Hillhouse
David R. Hammond
Eliza C. Finkenstaedt
Davis, Graham & Stubbs
P. O. Box 185
2600 Colorado National Bldg.
Denver, Colorado 80201
Telephone: (303) 892-9400

L. Robert Anderson
Lyle R. Anderson
Anderson & Anderson
P. O. Box 275
Monticello, Utah 84535
Telephone: (801) 587-2222

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Modrall, Sperling, Roehl, Harris & Sisk
P. O. Box 2168
Albuquerque, New Mexico 87103
Telephone: (505) 243-4511

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William A. Hillhouse
David R. Hammond
Eliza C. Finkenstaedt
Davis, Graham & Stubbs
P. O. Box 185
2600 Colorado National Bldg.
Denver, Colorado 80201
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Monticello, Utah 84535
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STATUS OF PROCEEDINGS

On September 29, 1983, appellants The Clovis National Bank and The Citizens Bank of Clovis (the "Clovis Banks") filed their brief (the "Clovis Brief") in this appeal. Respondent Atlas Corporation ("Atlas") filed its brief (the "Atlas Brief") with the Court on October 31, 1983. The Clovis Banks now submit this Reply Brief which responds to new arguments and theories raised by Atlas in its brief.

INTRODUCTION

In its brief, Atlas demonstrates its continuing inability to get its story straight. Atlas still has not formulated a consistent construction of the Agreements that can support the district court's ruling. On the most crucial factual and construction issues, Atlas' argument collapses in self-contradictions. For example, at one point in its brief, Atlas unambiguously disavows the "one ore body" theory upon which it relied in the court below,[1] and upon which the district court at least in part based its decision, see, e.g., Findings and Conclusions ¶¶11, 19-21, 29, 39, R. 2084-86, 2089-2092, 2098. Atlas now argues that the Agreements covered a single "mining venture" and

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[1] See, e.g., Motion of Atlas for Summary Judgment at 33, R. 1507. For the Court's convenience, the Clovis Banks will continue the citation form used in the Clovis Brief. Citations to documents in the record will include the title of the document, the page number or section of the document, and a citation to the record.

the "mining venture" involved a single ore body, but that was merely the way things turned out; nothing in the Agreements limited the "venture" to one body. Atlas Brief at 49. In place of the "one ore body" theory, Atlas substitutes a "sequential operation" construction. Using this logic, Atlas asserts that the Agreements contemplated a conditional sequence of operations which, once performed, caused the Agreements to expire. Yet when this construction, in turn, collides with language in the Agreements expressly providing for "exploration, drilling, development, [and] mining" after the initial sequence of operations, see Operating Agreement § III, 1548-49, Atlas simply reverts to its earlier story. The damaging language, Atlas argues, must be understood to refer only to additional operations on the first ore body. Atlas Brief at 37-38.

Atlas similarly vacillates in its description of the most essential facts. Attempting to support the district court's ruling, Atlas indicates at one point that the Claims had been fully explored before the Bardon Shaft was abandoned in late 1960 or early 1961, so that the closure of the Bardon Shaft completed performance, and the Agreements and the Net Profits Interest were extinquished at that time. Atlas Brief at 23 n. 7. However, when confronted with incontrovertible evidence that Kerr-McGee planned further operations and considered the Agreements to be in effect in 1962, see e.g., Letter from Kerr-McGee to Wm. Dean McDougald (May 9, 1962), R. 1882; Affidavit of Richard T. Zitting

¶ 1773, Atlas abandons this position and argues that Kerr-McGee must have completed performance, and resolved that no further work would be done, "some time near December 30, 1962." Atlas Brief at 50 n. 142 (emphasis added).

These contradictions are not inadvertencies, they reflect the fact that Atlas is spinning a tale which has only occasional and tenuous connections to the actual language of the Agreements and to the evidence of what actually happened. A review of Atlas' arguments demonstrates that Atlas cannot invent, much less support, a construction of the Agreements or a version of the historical events that would sustain the district court's rulings. As a result, even if its contradictions could be overlooked, Atlas' argument is manifestly inadequate to support a summary judgment.

The arguments offered by Atlas attempt to divert the Court's attention from a common sense evaluation of the transaction as a whole to an approach that requires an intricate dissection of a few of the words and phrases used in the Agreements. The intricate construction urged by Atlas places more emphasis on these isolated bits of the Agreements than the parties could have possibly contemplated. As will be demonstrated, this Court should not focus upon the subtle intricacies and shadings urged by Atlas or follow the numerous "red herrings" offered by Atlas to support its irrelevant conclusions. Rather, the Court should step back from the 1957 transaction and view it

as a whole, giving a fair and literal meaning to the language of the Agreements.[2] The Court should enforce the Agreements according to their plain meaning and give effect to the deal as struck by the parties in 1957 rather than as viewed by the district court, which based its construction upon an unanticipated hiatus in operations that occurred in the 1960's.

The Court should reverse the decision of the district court and remand with instructions to grant summary judgment in favor of the Clovis Banks.

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[2]In so doing, the Court should seek to answer a few basic questions. First, did the Interest Owners clearly intend to give up all of their interest in over 700 acres of mining claims in exchange for a one-shot exploration effort on one edge of the Claims by Kerr-McGee? The potential of the Claims was obviously known to them, see Deposition of R. D. Boone at 36-37, 42, R. 1142-43, 1148, but only a fraction of the Claims had been explored, see, Deposition of William McDougald at 75(4) - 77(10), 116(21) - 117(19), R. 447-48, 488-89. Second, could the parties have clearly intended that the express language of duration set forth in the Operating Agreement be superceded by implied language that limited their deal to a "single mining venture"? Third, after acknowledging that the Operating Agreement pertained to all of the Claims, could Kerr-McGee's actions in abandoning a very specifically described 7.5 acre tract be implied to terminate the entire Agreement? Finally, by defining a series of activities related to evaluation and development of the initial exploration target, did the parties mean to rule out all later exploration and development activities? If all of these questions or the numerous other questions raised in this brief cannot be answered with an unequivocal "yes", this Court must reverse the judgment of the district court and rule in favor of the Clovis Banks.

ARGUMENT

ATLAS HAS FAILED TO PRESENT ANY PLAUSIBLE RATIONALE TO SUPPORT THE DISTRICT COURT'S CONCLUSION THAT THE AGREEMENTS AND THE NET PROFITS INTEREST HAVE EXPIRED OR TERMINATED.

A. Atlas' Contention that the Agreements Contemplated a "Conditional and Sequential" Operation cannot Support the Conclusion that the Agreements, or the Net Profits Interest, Have Expired.

Atlas' principal argument is that the Agreements contemplated a sequence of operations in which only the first stage, i.e., exploration, was mandatory. Under this theory, only if exploration resulted in the discovery of ore would a mine be developed, and only if the mine generated profits would there be a distribution of proceeds. This argument proves precisely nothing, since it is undisputed that exploration has occurred, a mine has been developed, and profits have been generated.

Indeed, Atlas wholly misconceives the "conditional" nature of the operator's obligations. That a mine cannot be developed unless ore is found, and that profits cannot be distributed unless they are generated, are not consequences of any "conditions" imposed by the Agreements. Rather, they are simply obvious facts of nature. The provisions creating the Net Profits Interest do not refer to any conditions, but make the interest applicable to "all ores mined, produced, saved and sold from said premises." Agreement at 5, R. 1540; Operating Agreement at 4, R. 1549. Of course, if no ores were "mined, produced, saved and sold" no revenue would be generated for the Net Profits Interest owners. This result would not be because the interest would

"terminate" or "expire," but would merely be because there would be no profits to distribute. On the other hand, when ore is found and profits are generated (as has in fact happened), the provisions applicable to such profits must determine their distribution.

Attempting to confer cogency on its argument, Atlas asserts that the Agreements contemplated a sequential operation that would be performed only once, and that subsequent operations would thus not be covered by the Agreements. Atlas Brief at 36-38. This construction must be rejected for at least three reasons. First, Atlas has conjured up the "single sequence" construction out of the air; the Agreements nowhere state that they are limited to a single sequence of operations. Instead, the Agreements expressly provide that they will continue in force so long as any of the Claims are in effect. See e.g., Operating Agreement at 2, R. 1547. Second, the "sequential operation" language upon which Atlas purports to rely appears in a section dealing with "Commencement of Activities . . .." Id. at 3, R. 1548 (emphasis supplied). Thus, the very title of the section indicates that any sequence of operations described therein cannot be understood to limit the entire scope of activity, but merely refers to the initial exploration target. Moreover, the same section upon which Atlas relies as the foundation for its theory expressly provides for additional "exploration, drilling, development, [and] mining" after the initial operations. Id.

this language affirmatively proves that the Agreements did not contemplate only a one-shot sequence of operations. Finally, Atlas provides no basis for interpreting these express obligations as anything more than additional express obligations undertaken by the operator that were not conditions precedent to anything.

B. Atlas' Contention that the Agreements were "Fully Performed" Is Wholly Without Support in the Evidence or in the Agreements.

Atlas contends that after initial exploration of the Claims, Kerr-McGee decided that further exploration was unwarranted. Atlas Brief at 24-25. Atlas argues that this supposed decision meant that performance was "complete," thus somehow causing the Agreements to terminate. Id. The assertion that Kerr-McGee decided further exploration was unwarranted is rank fiction. See infra at pp. 44-48. Yet even if Kerr-McGee had reached such a decision, the contention that this decision would have terminated the Agreements or extinquished the other parties' rights is flatly at odds with the language of the Agreements. Nowhere in the Agreements is there any provision defining "full performance" or indicating that upon any level of performance the Agreements would terminate or expire. Instead, the Agreements provide that they will not terminate so long as any of the Claims remain in force. See Operating Agreement § I, R. 1547. Atlas' argument seeks to rewrite not only the Agreements in this case,

but the law of contracts as well. Agreements often create multiple obligations. A party's performance of one obligation among multiple obligations hardly operates to discharge the other obligations or to terminate the agreement. Yet according to Atlas, that has happened in this case.[3]

The Agreements imposed a number of obligations on the operator. Section 5 of the Agreement and the first part of Section III of the Operating Agreement require the operator to explore and develop the Claims. Section 6 of the Agreement and the second part of Section III of the Operating Agreement require the operator to pay the Interest Owners a specified percentage of "all ores mined, produced and sold from said claims." Atlas argues that the alleged performance of the first duty by Kerr-McGee, the original operator, discharged the latter duty as well,

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[3]Atlas' proposed construction is flatly at odds with this Court's policy of construing contracts and evidence in a manner that does not work a forfeiture of rights. As this Court declared in Wingets, Inc. v. Bitters, 500 P.2d 1007, 1010 (Utah 1972):

> [I]nasmuch as the plaintiff had its attorneys draw the contract, its provisions should be construed most strictly against plaintiff, and this is especially true as to a forfeiture, which is enforced only when the terms are clear and unequivocal.

See also U-Beva Mines v. Toledo Mining Co., 471 P.2d 867, 869 (Utah 1970) (recognizing a "generally accepted policy against forfeiture. . ."); cf. Continental Oil Co. v. Board of Review, 568 P.2d 727, 730 (Utah 1977)("a statute for a forfeiture should be strictly construed").

... that the operator was no longer required to distribute profits from ores mined, produced and sold from the Claims. Atlas Brief at 24-33. There is simply no support, either in contract law or in the language of the Agreements, for this strikingly illogical conclusion.[4]

Atlas seeks refuge in a number of hypotheticals that are counterfactual and thus beside the point. (E.g., If no ore had been found, then . . . . If no profits had been earned, then . . . .) Atlas Brief at 19-22, 36. However, a different hypothetical, which upon inspection turns out not to be counterfactual, highlights the absurdity of Atlas' reasoning. Suppose Kerr-McGee had explored and, finding nothing at first, had

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[4] Atlas' contention that Kerr-McGee fully performed its duty to explore merely attempts to divert the Court's attention to a false issue which need not even be addressed. Atlas argues at length that the Operator's duty cannot be understood to require endless exploration, Atlas Brief at 32, and that any claim the Interest Owners may have had for breach of this duty has been lost by inaction and passage of time, id. at 52-53. Such arguments amount to a mere red herring. The Clovis Banks have not alleged any such breach. To be sure, the extent of an operator's duty to explore may, in some cases, raise difficult questions. Those questions are hardly pertinent here. In the present case, it is undisputed that Kerr-McGee and/or at least one of its successors did conduct further exploration of the Claims after closure of the Bardon Shaft, and that such exploration has resulted in the discovery and mining of vast amounts of ore. See Clovis Brief at 10; Atlas Brief at 13. Moreover, it is undisputed that the Agreements contain unambiguous provisions defining the parties' rights to share in the profits from that ore. See Agreement ¶6, R. 1540-41; Operating Agreement §§ III, IV, R. 1549-50. How other provisions in the Agreements might be interpreted if the facts had been different is a question far beyond the bounds of proper consideration.

decided and announced that further exploration was not justified, but then changed its mind, resumed exploration, and struck a bonanza. Kerr-McGee obviously could not have claimed that its earlier decision to end exploration had extinquished the Interest Owners' rights to their specified share of the profits. Yet (although there is in reality no evidence that Kerr-McGee or the subsequent operator ever decided to discontinue exploration), that is in substance exactly the claim that Atlas now makes. To be sure, the bonanza was discovered not by Kerr-McGee itself but by a successor. That fact makes no difference, however, because, the Agreements are unambiguously applicable to "successors and assigns."

Atlas' present construction necessarily acknowledges that if Kerr-McGee had found and mined additional ore, then the production of such ore would have been subject to the Net Profits Interest.[5] Thus, the unavoidable conclusion is that the Agreements, and the Net Profits Interest, do apply to the profits earned by Atlas as Kerr-McGee's successor.[6]

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[5]Atlas Brief at 49: "The AGREEMENTS, and the mining venture, applied to whatever KERR-MCGEE found in its testing, defining and developing of the SUBJECT CLAIMS."

[6]Any other interpretation would be unreasonable, since it would allow any operator to acquire mining property and then immediately nullify all of the grantor's reserved rights simply by conveying the property to a successor. General principles of contract construction require that such unreasonable interpretations be disregarded. See, e.g., Weiner v. Wilshire Oil

C. Atlas Has Offered No Colorable Explanation for the Numerous Provisions Making the Net Profits Interest Applicable to All Ores Mined from "Said Claims" So Long as the Claims Remain in Force.

Atlas' assertions that the Agreements contemplated a sequential operation and that Kerr-McGee fulfilled its duty to explore the Claims exhaust Atlas' affirmative arguments for its favored construction. The balance of Atlas' construction arguments consists of an effort to explain away the provisions stating that the Agreements continue in effect so long as the Claims are in force and that the Net Profits Interest applies to "all ores" mined from "said claims." However, the proferred explanations merely serve to underscore the frailty of Atlas' position.

1. Section I - the "Period of Agreement" provision.

Section I of the Operating Agreement defines the "Period of Agreement Concerning Operations," and unambiguously provides that the Agreements will continue so long as any of the Claims remain in force. Operating Agreement at 2, R. 1547. Acknowledging that the Claims are still in force and that no termination has occurred under Section I, Atlas suggests that the Section is only one of "many limitations" on duration contained in the Agreements, and that the Agreements were terminated under other limitation provisions. Atlas Brief at 17-18.

Co , 192 Kan. 490, 389 P.2d 803 (1964).

In making this argument, Atlas studiously avoids actually quoting Section I, because the language in fact precludes Atlas' construction. Indeed, Section I is not a "limitation" provision at all, but rather a non-limitation provision:

> It is agreed by and between the parties hereto that this Agreement shall be in full force and effect so long as any of the mining claims hereinabove identified and described are in force and effect.

Operating Agreement § I, R. 1547.

Thus, Section I does not establish conditions for limiting or terminating the Agreement. Its whole effect is to disclaim any such conditions. The plain language of Section I, therefore, precludes precisely the kind of "implicit termination" construction that Atlas urges. Moreover, Atlas' suggestion that Section I was included in the Agreements merely to cover the possible situation in which "the United States or some rival locator [might] obtain a ruling that the SUBJECT CLAIMS were invalid," Atlas Brief at 17, would simply render the section superfluous. A determination of invalidity would obviously nullify the parties' rights and duties under the Operating Agreement as a matter of law. Moreover, even if the actual language of Section I could be disregarded, as Atlas evidently prefers, it is hardly likely that the parties would have included under the title of "Period of Agreement" in the very first section of the Operating Agreement, such an utterly pointless provision.

2. The provisions tying the duration of the Net Profits Interest and the Agreements to "said claims."

As noted in the Clovis Brief, the Agreement and Operating Agreement repeatedly make their duration and the parties' rights and obligations co-extensive with the duration of the Claims. Clovis Brief at 18-22. The Net Profits Interest, for example, is expressly made applicable to "all ores mined, produced, saved and sold from said claims." Operating Agreement at 4, R. 1549 (emphasis added).

In response, Atlas boldly asserts that the phrase "said claims" are used "in conjunction with - even interchangeably with - the terms 'mine'; 'ore body', and 'shaft.'" Atlas Brief at 39. However, Atlas does not cite a single instance of such supposed interchangeable usage. Thus, while the meaning of the phrase is obviously crucial in the construction of the Agreements, Atlas offers not even the barest pretense of textual support for its proposed construction.

In fact, the Agreements are perfectly clear on this point. The first page of the Agreement gives a precise legal description of the Velvet and Royal Flush claims and then immediately abbreviates that description with the phrase "said claims." Agreement at 1, R. 1536. The first page of the Operating Agreement does the same. Operating Agreement at 1, R. 1546. In case there could be any confusion, Section I of the Operating Agreement then makes the Agreement effective "so long

as any of the mining claims hereinabove identified and described are in force and effect." Id. at 2, R. 1547 (emphasis added). Both Agreements repeatedly use the phrase "said claims" without ever hinting that any limitation to a "mine," "shaft," or "ore body" might be intended. Indeed, before any of these terms even appear in the Operating Agreement, the phrase "said claims" has already been employed several times in direct reference to the legal description of all of the Velvet Claims. See id. at 1-2, R. 1546-47. Thus, Atlas' suggestion of an implicit synonymity is flatly at variance with the language of the Agreements.

3. The provisions subjecting "all ores" to the Net Profits Interest.

The Agreements expressly contradict the construction proposed by Atlas that the Net Profits Interest applied only to ores from an initial mining venture and thus is not applicable to ores produced from the Velvet Mine. The Net Profits Interest expressly applies to "all ores mined, produced, saved and sold from said claims." Operating Agreement at 4, R. 1549 (emphasis added). Atlas now seeks to avoid this provision by suggesting an ingenious construction; the phrase "all ores" does not mean "all ores," but rather "all kinds of ores," i.e., uranium, vanadium, thorium, manganese, etc. Atlas Brief at 38-39.

This construction simply does not work. The construction merely reads into the Agreements a limitation that cannot be found anywhere in, and indeed is contradicted by, the language of the Agreements. To be sure, the Net Profits Interest is

applicable to all kinds of ores, as the phrase "all ores" suggests and as the Agreement specifies. Agreement at 23-24, R. 1536-37. But it hardly follows that because "all ores" can be understood to include "all kinds of ores" it can then be read to mean "some of all kinds of ores." The term "all ores" cannot be metamorphased into "not all ores," simply by the use of an intermediate step.

4. The provisions expressly contemplating subsequent "exploration, drilling, development, [and] mining."

Section III of the Operating Agreement expressly provides for "exploration, drilling, development, [and] mining" after the development of the "initial" mine, thereby destroying Atlas' position that the Agreements contemplated a sequence of operations that would be performed only once. Operating Agreement at 3, R. 1548. See also Agreement at 5, R. 1540. Attempting to explain away these provisions, Atlas suggests that the language refers only to additional exploration, drilling, and mining that might be performed on the initial ore body. Atlas Brief at 37-38.

Typically, Atlas is not troubled by the fact that the language of the Agreements suggests no such limitation, and indeed explicitly refers to later exploration and mining of "said claims," not of "said ore body." Operating Agreement at 3, R. 1548. Even if these textual problems could be overlooked, the argument merely evidences Atlas' inability to make up its mind as

to why the Agreements terminated. Earlier, as has been explained, Atlas purported to find in the Agreements a "one ore body" limitation. See supra p. 1. For good reason, Atlas now purports to eschew that position,[7] and in its present brief tries to develop a construction based on the assumption that the Agreements contemplated a sequence of operations that would be performed only once. Atlas Brief at 34-37. That construction, however, is in turn prevented by the express provisions governing continued operations after the first sequence of operations. In addition, the "single sequence" argument is not strengthened by Atlas' attempt to smuggle back into the case the already discarded "one ore body" theory.

Atlas has seemingly adopted a "flip-flop" strategy. Faced with insurmountable difficulties in the "one ore body" theory, Atlas recants and proposes a "single sequence" construction instead; but when that construction collides head-on with the text of the Agreements, Atlas tries to gloss over the problem by hauling out (though only for a moment) the "one ore body"

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[7] E.g., Atlas Brief at 49: "THE AGREEMENTS, and the mining venture, applied to whatever Kerr-McGee found in its testing, defining and developing of the SUBJECT CLAIMS. As it turns out, only one ore body (the BARDON MINE) was discovered, defined and developed. As it turned out, only one shaft was used. The AGREEMENTS did not terminate because, from the outset, they were limited to a single ore body."

history again. The flip-flop maneuver merely highlights the insuperable flaws in Atlas' position.

D. Considered as a Whole, the Agreements Preclude the Construction Favored by Atlas.

Insisting that the Operating Agreement must be read as a whole, Atlas suggests that the Clovis Banks' construction is based entirely on the first and last sections of the Operating Agreement. Atlas Brief at 34-35. These provisions have been discussed at length in the Clovis Brief and need not be repeated at length here. Very briefly, it may be noted that Section I unambiguously makes the duration of the Operating Agreement coterminous with the existence of the Claims, Operating Agreement § 1, R. 1547; that the Operating Agreement's recitals provide that the Interest Owners "have reserved unto themselves an undivided net profits interest . . . in and to the net profits from all ores, mined, saved, removed, and sold from said claims," Id. at 1, R. 1546 (emphasis added); that Section III contains a similar provision, as well as language expressly contemplating continuing exploration, development, and mining, Id. § III, R. 1548-49; that Section V explicitly provides for "mines" (in the plural), Id. § V, R. 1550-51; and that Sections VIII and XVIII are unambiguous in providing that all terms of the Agreement would bind successors and assigns. Id. § VII, at 9, R. 1554; Id. § XVIII, R. 1560.

Thus, the Clovis Banks' construction is supported by numerous provisions throughout the Operating Agreement. By

contrast, it is Atlas whose construction of the Agreements is based solely on an interpretation of language in Section III of the Operating Agreement.

II. THE NET PROFITS INTEREST IS AN ESTATE IN LAND BINDING UPON ATLAS.

Atlas next asserts that the parties to the 1957 Agreements did not intend to create a perpetual net profits interest with characteristics of other estates in land. As a result, Atlas agrues, the interest does not bind it under generally accepted principles of contract law. However, rather than provide substantive rebuttal to the Clovis Banks' position that the Net Profits Interest is an interest in land, Atlas merely repeats its prior argument that the Agreements terminated and that the Net Profits Interest was somehow abandoned in the process.

A. The Net Profits Interest Is An Interest in Land Binding Upon Subsequent Owners of the Claims.

Atlas' argument is based upon its conclusion that "[n]one of the authorities cited by the Clovis Banks stand for the proposition that all net profits interests are mineral interests or estates in land or any other perpetual interest." Atlas Brief at 42-43 (emphasis added). The Clovis Banks have not asserted, and do not here assert, that all net profits interests are interests in land. The Clovis Banks do assert, however, that an analysis of the Net Profits Interest created by the April 18, 1957 Agreement demonstrates that it is an estate in land, rather

than a mere "share in a common fund of profits" unrelated to the claims, as contended by Atlas. Atlas Brief at 42.

Atlas agrees that "net profits interests may share some of the characteristics of an overriding royalty interest, a royalty, a working interest, or a carried interest." Atlas Brief at 42. Atlas then inconsistently asserts that the Net Profits Interest defined in the Agreements is "unlike any of those interests." Id. (emphasis added). First, Atlas asserts that the Net Profits Interest is unlike a royalty interest because a royalty "is not a cost bearing interest at all, and is calculated without respect to costs or profits." Id. at 42 n. 115. Incredibly, Atlas apparently overlooks the fact that both a working interest and a carried working interest -- each of which are indisputably estates in land -- are cost-bearing interests calculated on costs or profits.

Second, Atlas emphasizes that the Net Profits Interest is a "share in a common fund of profits and [the Interest Owners'] share is dependent upon the operations attaining a specific level of profits." Id. It is patently obvious, of course, that any interest, such as a working interest, that is calculated on a "net" basis[8] comes from a common fund of

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[8] Even gross proceeds royalties frequently share some costs, such as transportation or smelting charges. Gushee, Drafting Practical Royalty Clauses for the Mining Lease, 2 Rocky Mtn. Min. L. Fdn. 625, 634-640 (1975). As a result, these interests are

profits, because if one interest owner receives a specified percentage of proceeds, the other interest owners can only share in what is left of the common fund. Indeed, this point reinforces the characterization of the Net Profits Interest as an interest in land. The Net Profits Interest is measured as a share of common production from the Claims, rather than an interest in Atlas' revenues generally. Atlas provides no authority for the proposition that sharing in a common fund of proceeds from production somehow destroys the nature of the Net Profits Interest as an interest in land. Atlas' argument seems to be that by merely calling the Net Profits Interest a "profit sharing arrangement" it will be held to be a mere contract right.[9]

Third, Atlas points out that that working interest owners have executive rights and the obligation to pay expenses but the Interest Owners do not. Atlas Brief at 42 n. 115. Because of this, Atlas concludes, the Net Profits Interest cannot be a working interest. Once again, Atlas overlooks the fact that these characteristics are exactly those reflected in the royalty

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likewise dependent upon operations achieving a specific level of profitability in order to produce financial returns.

[9]Interestingly, the parties to the Agreements never referred to the Net Profits Interest as a "profit sharing arrangement," but called it a "net profits interest" that was "reserved unto themselves." Operating Agreement at 1, R. 1546.

interest and the carried working interest, both of which are closely related to net profits interests and are uniformly recognized as interests in land.[10] Atlas also ignores the fact that the parties executed an Operating Agreement, an indication that the parties believed that the Interest Owners had executive rights.[11]

Finally, Atlas attempts to rely on two authorities, Atlas Brief at 41 n. 114, to support the proposition that net profits interests are not recognized as interests in land.[12] To be sure, as Atlas quotes, one authority contends that "any consideration of the nature of the net profits interest arrangement, which contains no further specificity beyond the words 'net

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[10] See 2 H. Williams & C. Meyers, Manual of Oil and Gas Terms 84 (1982) (noting "the close kinship between carried interests and net profits interests"). Just as carried interests, net profits interests are "carved out of the working interest." Id. at 457. The close relationship between the Net Profits Interest and working interests is further bolstered by the characterizations used by the Interest Owners. See Clovis Brief at 41-43.

[11] Only owners of executve rights must execute an operating agreement, which is defined as "an agreement among concurrent owners of interests in land." 2 H. Williams & C. Meyers, supra note 10, at 505.

[12] In the Clovis Brief, the Clovis Banks presented substantial support for the proposition that the phrase "net profits interest" is recognized as a term of art that describes an interest in land. Because Atlas has not attempted to refute those authorities, the Clovis Banks will not repeat their argument here.

profits interest' per se, is a leap into fantasy . . . ."[13] Atlas fails, however, to reveal to the Court that this authority's discomfort with the use of these words is not focused upon the concept that the interest is not an estate in land, but is due to the fact that many times, the needed "further specifity" is missing from the defining document. However, where that specificity is present -- as in the instant case -- Atlas' own authority agrees that "[n]et profits interests continue from and after their creation for the term of the property interest from which they are created so that a net profits interest is created from the working interest and is a continuing burden upon it." Sherrill, supra note 13, at 168. The other authority relied upon by Atlas is similarly quoted out of context and in fact supports the Clovis Banks' contentions.[14]

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[13]Sherrill, Net Profits Interests - A Current View, 19 Inst. on Oil & Gas L. & Tax'n 165, 166 (1968)(emphasis added). Sherrill notes that "[t]he frequent use through the years of net profits interest arrangements has tended to lead many practioners to consider the words 'net profits interest' to be words of art describing a unique interest -- almost in the same sense as do the words 'overriding royalty.'" Id. at 165.

[14]Atlas relies on 5 E. Kuntz, A Treatise on the Law of Oil and Gas §63.5 (1978). Professor Kuntz recognizes, as the Clovis Banks stated in the Clovis Brief, that net profits interests have not received broad treatment in the courts. Clovis Brief at 33. Kuntz also recognizes, as Atlas points out, Atlas Brief at 41 n. 114, that a net profits interest may be an interest in land and determination of the issue depends upon the provisions of the instrument creating it. 5 E. Kuntz, supra §63.5. The Clovis Banks have urged this Court to make such a determination by analyzing the characteristics of the Net Profits Interest and its

B. The Net Profits Interest was Properly Created in the Agreement and the Deed.

Atlas next objects to the manner in which the Net Profits Interest was created. Atlas Brief at 44 n. 118. Atlas asserts that the April 18, 1957 Agreement "did not define a net profits interest." Id. In fact, the Agreement uses an entire paragraph to define it, see Agreement ¶6, R. 1540-41, and the Operating Agreement and attached Accounting Procedure, which are incorporated into the Agreement, devote even greater length to the definition, Operating Agreement §§ III, IV, R. 1548-49. Indeed, in the Operating Agreement, the parties used terms of art generally applicable to real property interests in describing the interest created in the Agreement: "[S]aid Interest Owners have reserved unto themselves an undivided net profits interest . . . ." Operating Agreement at 1, R. 1546. Thus, the parties viewed the Agreement as creating and defining the Net Profits Interest and the Operating Agreement as governing the working relationship of that interest with the interests being conveyed to Kerr-McGee and Mercury.

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close affinity to other interests in land. Clovis Brief at 39-41. Because the Net Profits Interest is absolutely dependent upon, and is measured by production from, the Claims and because of the way the parties characterized it, even Professor Kuntz should be satisfied that the Net Profits Interest is an interest in land.

Finally, the Deed was made expressly "subject to the terms, covenants and conditions in that certain agreement dated the 18th day of April, 1957 by and between the parties hereto." Mining Deed at 2, R. 1533. The use of the words "subject to" limited the estate that passed to Mercury and Kerr-McGee and excluded from the conveyance the interest created in the Agreement. Atlas objects to this reasoning on the basis that "the words 'subject to' do not mean incorporate by reference." Atlas Brief at 44 n. 118. However, it is commonly recognized that "subject to" may mean charged with, subordinate to, conditioned upon, limited by, or reserving.[15] Moreover, the language used in the Deed is not a typical "subject to" limitation that appears as boilerplate in most deeds. Rather, the Deed makes the conveyance expressly "subject to the terms, covenants and conditions" contained in the Agreements, which undeniably includes the obligation to pay a share of proceeds to the owners of the Net Profits Interest.

A number of courts, including the Supreme Court of Utah, have gone so far as to recognize that the words "subject to" can operate to reserve an interest from a conveyance, see

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[15] See 40 Words & Phrases 591-97 (1964 & Supp. 1983). It is interesting to note that Atlas describes the conveyance to Kerr-McGee and Mercury as being "subject to" the Bowen royalty thus apparently recognizing that the words can be appropriately used to show that an interest passed in a deed is limited or burdened by a previously created interest. Atlas Brief at 7.

Aspen Acres Association vs. Seven Associates, Inc., 29 Utah 2d 303, 508 P.2d 1179 (1973); Johnson v. Peck, 90 Utah 544, 63 P.2d 251 (1937), and that the intent of the parties, rather than the technical use of the words controls the effect of such terms. See Hartman v. Potter, 596 P.2d 653 (Utah 1979). Indeed, in Hendrickson v. Freericks, 620 P.2d 205 (Alaska 1981) the Alaska Supreme Court recognized that "a number of cases interpreting [the words 'subject to'] as creating a reservation of rights in the grantor involve the reservation of an easement or subsoil rights to minerals." Id. at 209. If use of the words "subject to" can work to create a reservation of a new interest in an instrument, then no question should exist that the words "subject to" as used in the Deed executed on June 7, 1957 could exclude from the conveyance the interest created in the Agreement executed on April 18, 1957. Courts have uniformly viewed such language to mean, at the very least, that the grant is limited by some pre-existing right, such as the right to share proceeds as defined in the Agreements. See, e.g., Hyman v. District of Columbia, 247 F.2d 585 (D.C. Cir. 1957); Cockrell v. Texas Gulf Sulphur Co., 157 Tex. 10, 299 S.W.2d 672, 678 (1957).

The Supreme Court of Texas and the New Mexico Supreme Court have likewise very recently ruled that a deed made "subject to" some other interest or instrument, binds the grantee under the deed and its successors with that interest or instrument. In Westland Oil Development Corp. v. Gulf Oil Corp., 637 S.W.2d 903

(Tex. 1982), a conveyance was made in a manner remarkably similar to that used in the present case:

> this Assignment shall be subject to all the provisions of that certain Operating Agreement dated March 1, 1968 by and between Assignor and Assignee. The provisions hereof shall be binding upon, and inure to the benefit of the parties hereto and their respective heirs, devisees, legal representatives, successors and assigns.

Id. at 906. In holding that the assignees and their successors were bound by the equitable interests described in the March 1, 1968 Operating Agreement, the Court stated:

> [W]e hold that the reference to the March 1, 1968, operating agreement contained in the May 22, 1973, assignment from Mobil to Gulf and Superior, as a matter of law, charged Gulf and Superior with the duty of inspecting said agreement. As a result, Gulf and Superior were charged with notice of the November 15, 1966, letter agreement and the equitable claim of Westland, and cannot enjoy the status of innocent purchasers.

Id. The same logic should control in the case at hand and Atlas' interest in the Claims should be held to be burdened by the Net Profits Interest.[16]

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[16] In National Bank of Commerce v. Dunn, 381 S.W.2d 654 (Tex. Ct. App. 1964), a case similar to the instant case, the Texas Court of Civil Appeals held that a grantee under a deed made "subject to" a previously created but unrecorded net profits interest was bound by the deed and obligated to honor the interest:

> The rule is that where a person takes a conveyance of land and in the deed into him, which is accepted by him, it is recited that

THE NET PROFITS INTEREST IS ENFORCEABLE AGAINST ATLAS AS A COVENANT RUNNING WITH THE LAND BOTH IN LAW AND IN EQUITY.

Atlas argues in its brief that the Net Profits Interest is not enforceable because Atlas and the Clovis Banks were not the original parties to the Agreements. Atlas Brief at 53-54. Atlas relies on a 1954 decision of a Texas appellate court, LeBus v. LeBus, 269 S.W.2d 506 (Tex. Civ. App. 1954), for the broad proposition that the Net Profits Interest in this case is "at the most a contract right" unenforceable against successors that have not expressly assumed the obligations imposed by the Agreements. Atlas' reliance on LeBus, however, is misplaced. In LeBus, the issue presented was whether a partnership existed under the facts before the court, not whether net profits interests are generally enforceable against successors in interest.[17]

> he takes it subject to some contract he thereby admits its existence and its validity as of that time. He cannot attack its validity because he has acknowledged its valid existence as of that time and as a part of the consideration has contracted to honor it.

Id. at 662 (citations omitted). See also LexPro Corp. v. Snyder Enters., Civ. No. 14848 (N.M. Sept. 21, 1983), N.M. St. Bar Bull. 1045 (Oct. 6, 1983).

[17] In LeBus, two brothers had been engaged in several oil and gas ventures. On one occasion, one brother did not have sufficient capital to participate in the purchase of a particular lease. The brothers consequently entered into an oral agreement that if the non-cash contributing brother rendered services in negotiating lease terms for acquisition of the desired lease, the other brother would pay to the service contributor 1/4 of the net profits of any resale or 1/4 of the net profits of production.

Under the law of real covenants, successors in interest are bound by the terms of covenants that are related to land, without expressly assuming any obligations. Indeed, enforceability of covenants without express assumption is the basis for the law of real covenants. As the Clovis Banks demonstrated in their brief, the covenant to pay net profits is enforceable against Atlas both in law and in equity. Several points raised in the Atlas Brief distort the law and the facts and, therefore, merit further mention.

A. The Net Profits Interest is Enforceable At Law.

The Clovis Brief addresses the elements required for real covenants to run with land at law and demonstrates that those elements are satisfied in this case. Clovis Brief at 51-59. The Net Profits Interest touches and concerns both the possessory estate in the Claims and the Interest Owners' retained interest; the element of privity is satisfied; and the parties clearly intended the covenant to run with the land. Atlas agrees that if these elements are present, the covenant

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The court determined that it was the intent of the parties only to enter a contract for personal services as opposed to a partnership agreement. Therefore, when the service contributor died, the personal service contract terminated and there was no partnership interest for the heirs of the service contributor to inherit. Because LeBus deals with strictly a partnership question, there is no way it can be even remotely construed as authority for the proposition that net profits interests are held to be contract rights.

will run at law, but asserts that none of the elements is satisfied in this case. Atlas Brief at 55.

1. The covenant to pay net profits touches and concerns the Interest Owners' retained interest in the Claims.

The thrust of Atlas' argument is that, because the Clovis Banks have not succeeded to a sufficient estate in the Claims, the covenants in the Operating Agreement do not satisfy the requirement that the covenants "touch and concern" the land. Atlas' argument fails, however, to address adequately the cases and authorities cited by the Clovis Banks, which demonstrate that the rights in the Claims retained by the Interest Owners (to which the Clovis Banks have succeeded) constitute a sufficient estate to satisfy these elements.[18] Instead, Atlas focuses on two decisions of this Court, Atlas Brief at 57-58, which deal with the issue of whether the covenant must be related to the physical use of land, and an isolated 1943 decision of the West

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[18] Clovis Brief at 53-54. It is unnecessary for this Court to engage in the type of detailed inquiry into the exact label that should be placed on the retained interest, as Atlas seems to urge is necessary. See Atlas Brief at 59 n. 169. Such rights have received various labels in the unique context of the mineral estate, as remainders, possibilities of reverter and others. See, e.g., Williams v. Watt, 668 P.2d 620 (Wyo. 1983). Regardless of the label, courts uniformly enforce covenants to pay royalties under the law of real covenants whether based on gross or net proceeds. See cases cited in the Clovis Brief at 53-54.

Virginia Supreme Court, id. at 59, which has been severely criticized by oil and gas law authorities.

As pointed out in the Clovis Brief, Clovis Brief at 52, this Court has stated in dicta in the specific context of land development, that a covenant must have a permanent effect of a physical nature on land itself to satisfy the touch and concern element. See First Western Fidelity v. Gibbons and Reed Co., 27 Utah 2d 1, 492 P.2d 132 (1971) (dicta). However, in the later case of Lundeberg v. Dastrup, 497 P.2d 648 (Utah 1972), this Court restated the test in its holding:

> In order for a covenant to run with land it 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.

Id. at 650 (emphasis added). Thus, the test does not look to whether the covenant has an effect of a physical nature on the land, but whether the performance or nonperformance affects the use, value or enjoyment of land.[19] The covenant to pay the Net Profits Interest in this case affects the use, value, and enjoyment of both the covenantors' and covenantees' interests in

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[19] Indeed, the Lundberg court went on to list specific covenants affecting the use, value or enjoyment of land, which obviously have no effect of a physical nature: "Examples are the covenants of seizen, the right to convey, freedom from encumbrances, and of quiet peaceable possession." Id. Accord Hudspeth v. Eastern Oregon Land Co., 430 P.2d 353, 356 (Or. 1967).

the Claims, and therefore satisfies the touch and concern element as phrased by this Court in Lundeberg.

To bolster its position that the touch and concern element is not satisfied, Atlas relies heavily on the case of McIntosh v. Vail, 126 W.Va. 395, 28 S.E.2d 607 (1943).[20] That case, however, adopts an extreme minority position and has been criticized by authorities in the mining and oil and gas field.[21] The majority of courts and authorities do not follow the West Virginia view. As noted in the Clovis Brief, covenants to pay royalties whether based on net or gross proceeds, are

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[20] In McIntosh, the court held that specific language used in an instrument did not evidence an intent to make a covenant to pay an oil and gas royalty a real covenant. The decision was 3 to 2 and the dissent adopts the orthodox view that covenants to pay mineral royalties are real covenants.

[21] Referring to the West Virginia line of decisions that includes McIntosh, Williams and Meyers state, "Fortunately this contribution to the learning on oil and gas law has not received wide circulation." 1 H. William & C. Meyers, Oil and Gas Law §304.9, at 494.1 n.8 (1981). The early West Virginia cases apparently adopt a rule of construction influenced by Coke's Rule which states: "But if a man seized of lands in fee by his deed granteth to another the profits of those lands, . . . the whole land itself doth pass; for what is land but the profits thereof. . . ." Coke upon Littleton 4b (17th ed. 1817). To avoid the rule that the fee follows a grant of the profits, older West Virginia cases favor a construction of mineral grants and reservations limiting the duration of royalty-type interests. See 1 H. Williams & C. Meyers, supra at §304.9. As suggested by Williams and Meyers, this Court should avoid introducing this archaic rule into Utah law.

uniformly accepted as satisfying the "touch and concern" element and run with land.[22]

2. The parties plainly expressed their intent that the covenant was to run with the land.

Atlas next asserts that the parties did not have the necessary intent for the covenant to pay net profits to run with the land, despite the plain language in the Agreements that its terms and provisions "be deemed to be covenants running with the land," Operating Agreement at 9, R. 1554, and that the terms and provisions are binding on "heirs, administrators, successors and assigns." Id. at 15, R. 1560. Atlas attempts to negate this plain language with two arguments. First, Atlas asserts that the language in Section VIII of the Operating Agreement deals only with the rights of Kerr-McGee and Mercury. Second, Atlas argues that the language in Section XVIII is "standard boilerplate" somehow not intended to refer to successors and assigns and not specific enough to express an intention that the Net Profits Interest runs with the land.[23] These arguments are without

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[22]Clovis Brief at 53-54. Because the interest retained in the Claims by the Interest Owners (to which the Clovis Banks are direct successors) is sufficient to satisfy the "touch and concern" requirement, it necessarily follows that the element of privity is also satisfied. See 5 R. Powell, The Law of Real Property, ¶673[2], at 60-64 (1981).

[23]Atlas bases this argument, in part, on the district court's conclusion that many of the terms, covenants and conditions in the Operating Agreement are purely mechanical matters which could not have been intended to run. Atlas Brief at 61. However, the

merit and ignore the well established rule of construction that "[a]n express statement of the parties as to the 'running' of the covenant should normally be decisive." [24]

Section VIII of the Operating Agreement directly addresses the possibility of a transfer of the Claims to successors of Kerr-McGee and Mercury and provides, without limitation, that:

> All sales made by either Kermac or Mercury or their respective successors in interest, shall be subject to the terms, covenants and conditions of this Agreement, and such terms, covenants and conditions shall be deemed to be covenants running with the land and the mineral estate covered hereby and with such transfer or assignment thereof.

Operating Agreement at 9, R. 1554 (emphasis added). This language expressly applies to the terms, covenants and conditions of the Agreement, not just the terms, covenants and conditions of Section VIII, as concluded by the district court. This section of the Agreement is the most logical place for the parties to express their intent that the covenants within the Agreement were

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terms and covenants of Operating Agreements (including so-called mechanical matters) are commonly enforced against successors in interest. See, e.g., Westland Oil Development Corp. v. Gulf Oil Corp., 637 S.W.2d 903 (Tex. 1982).

[24] 5 R. Powell, supra note 22, ¶673[2] at 60-52; Clovis Brief at 53-54. The only exception to this rule is where one of the other elements is missing. See 5 R. Powell, supra note 22, ¶ 673[2] at 60-53. As demonstrated above and in the Clovis Brief, the elements of privity and touch and concern have been met in this case.

to run with the land. Indeed, there is no other way that the parties could have more plainly expressed this intent. Similarly, in Section XVIII of the Operating Agreement the parties expressly repeated their intent that the Agreements were not binding on only the initial parties to the Agreement:

> The terms and provisions of this Agreement shall be binding upon and shall inure to the benefit of the parties hereto, their respective heirs, administrators, successors and assigns.

Id. at 15, R. 1560 (emphasis added). Again the parties referred to the terms of the Agreement in expressing their devolutive intent.[25]

Atlas relies solely on the case of City of Glendale v. Arizona Savings & Loan Association, 2 Ariz. App. 379, 409 P.2d

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[25]Atlas asserts that this language means only that "one who accepts an assignment of the AGREEMENTS can enforce them against those parties to the AGREEMENTS who were not parties to the assignment," and that this language does not address purchasers of the Claims who do not accept an assignment. Atlas Brief at 61. This argument is wholly without merit. Section XVIII expressly makes both the burdens and benefits of the Agreement binding on "successors and assigns" of all the parties to the Agreement. The definition normally attributed to the term "assigns" as used in the Agreements, includes "all those who take either immediately or remotely from or under the assignor, whether by conveyance, devise, descent or act of law." Black's Law Dictionary, "Assigns" (rev. 4th ed. 1968). Moreover, the term "assigns" is the language normally used to express the intent that covenants are to run with land. See 5 R. Powell, supra note 22, ¶673[2], at 60-51. There is no evidence here that the parties intended the term "assigns" to have an unorthodox meaning. Atlas acquired its interest in the Claims by conveyance and therefore is bound to the terms of the Agreement as an "assign."

299 (1965), for its argument that the language in the Agreement is not specific enough to show the parties' intent that the covenant to pay net profits runs with the land. Glendale, however, is clearly distinguishable from this case on its facts. The instrument involved in that case contained a provision similar to Section XVIII of the Operating Agreement. That general language, however, was negated by other specific language in the instrument which was in conflict with the devolutive intent expressed in the general provision. In this case, there are no specific provisions in the Operating Agreement that even remotely negate the general devolutive language in Section XVIII.

B. The Net Profits Interest is Enforceable in Equity.

Atlas argues that the covenant to pay net profits should not be enforced in equity based upon an assumption that equity requires a technical application of certain elements. The Utah Supreme Court has not previously adopted such a position, nor should it do so now. As discussed at length in the Clovis Brief, the key to the doctrine of enforceability of a covenant in equity is notice. Clovis Brief at 56-57. This doctrine is based upon the broad ground that where a purchaser acquires an estate with notice of an outstanding interest, the failure to enforce the covenant in equity would be unjust. Id.

1. Atlas had notice of the Net Profits Interest.

In an effort to avoid the equitable notice doctrine, Atlas now asserts that it did not acquire the Claims with actual

knowledge or notice of the Net Profits Interest and, therefore, should not be bound.[26] The district court expressly assumed, for purposes of this summary judgment, that Atlas at least had constructive notice of the covenant to pay net profits.[27] Authorities uniformly agree that even constructive notice satisfies the notice required for covenants to run with land in equity. See, e.g., Schartz v. DRB&M Real Estate Partnership, 5 Kan. App. 2d 625, 621 P.2d 1024 (1981); 5 R. Powell, supra note 22, ¶ 673[2], at 60-71 ("The rule of constructive notice charges a successor with notice of any equitable covenant which is duly recorded in a prior instrument for which the successor is required to search."). A contrary result would thwart the protection provided by the recording acts and would encourage those acquiring property interests to remain ignorant of interests disclosed by the record.

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[26] Atlas Brief at 63-64. The apparent thrust of Atlas' argument is that actual as opposed to constructive notice of the covenant is necessary to its enforceability in equity.

[27] See Findings and Conclusions at ¶45 n.3, R. 2107. Under Utah law, all parties dealing with real property are conclusively presumed to be on notice of the contents of recorded documents, Utah Code Ann. §57-3-2 (1974), and the contents of any documents that are referred to in the chain of title. See Haynes v. Gibbs, 110 Utah 54, 169 P.2d 781 (1946). Because the Agreements were expressly referred to in the June 7, 1957 Deed, Atlas was charged with notice of the contents of the Agreements at the time it acquired the Claims. Several additional documents of record plainly disclose the existence of the Net Profits Interest. See Memorandum of Clovis Banks at 10-13, R. 1301-04.

2. The Net Profits Interest is enforceable even if the benefit is in gross.

Additionally, Atlas argues that this Court should impose a strict "touch and concern" requirement in equity in determining if the covenant to pay net profits runs with the land. Atlas Brief at 62. Atlas' position is that the covenant should not run because the benefit does not touch and concern a separate parcel of land owned by the promisee, but is in gross. As demonstrated above and at length in the Clovis Brief, the benefit is not in gross, but touches and concerns the rights in the Claims retained by the Interest Owners. Clovis Brief at 52-53. But even if Atlas' technical application of the touch and concern argument is correct, the covenant should nevertheless be enforced under the better reasoned view that such covenant should be enforced in equity if Atlas took with notice.

The eminent authority on the law of covenants, Judge Charles E. Clark, concludes that no distinction should be made between benefits touching and concerning separate land of the promisee and personal benefits in determining whether the burden of a covenant runs with the land.[28] One authority has

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[28] C. Clark, Real Covenants and Other Interests Which "Run With Land" app. 1, 219-26, 239-41 (2d ed. 1947). Accord LexPro Corp. v. Snyder Enters., Civ. No. 14848 (N.M. Sept. 21, 1983), N.M. St. Bar Bull. 1045 (Oct. 6, 1983). Most other authorities are in agreement with Judge Clark's view. See, e.g., 2 American Law of Property § 9.32, at 430 (1952) ("there is no logical reason to recognize the enforceability of legal easements in gross and deny

suggested that the burden of a covenant should be defeated where the benefit is in gross "only if in all the circumstances the covenant unreasonably restrains alienation."[29]

The Net Profits Interest and all other types of royalty interests serve socially useful purposes and do not unreasonably restrain alienation. They allow development of mining properties in situations in which the mineral owner alone does not have sufficient capital to develop its property. Failure to enforce the Net Profits Interest would not only be unjust, see Clovis Brief at 57-58, but would be a mechanical application of the law of covenants that would result in the termination of a socially desirable type of covenant. Thus, this Court should enforce the covenant to pay net profits in equity because Atlas took the Claims with notice of the Net Profits Interest.

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the existence of equitable servitudes in gross"); 5 R. Powell, supra note 22, ¶ 673[2], at 60-47.

[29]Browder, Running Covenants and Public Policy, 77 Mich. L. Rev. 12, 43 (1978). Since public policy favors free alienability of land, some cases hold that the burden of a covenant is allowed to run only where the encumbrance is counter-balanced by a benefit to some other interest in land. See Note, Covenants Running with the Land: Viable Doctrine or Common Law Relic, 7 Hofstra L. Rev. 139, 143 (1978). However, the kinds of burdens imposed by covenants relating to land generally serve socially useful ends regardless of whether the benefit is in gross. Indeed, a careful analysis of decisions involving covenants shows that courts purporting to adhere to the strict touch and concern rule are liberal in allowing socially useful covenants to run

IV. BECAUSE THE AGREEMENTS ARE UNAMBIGUOUS, THE CLOVIS BANKS ARE ENTITLED TO JUDGMENT AS A MATTER OF LAW OR, AT THE LEAST, THE CASE SHOULD BE REMANDED FOR RESOLUTION OF DISPUTED FACTUAL ISSUES.

A. The Clovis Banks Are Entitled to Judgment as a Matter of Law.

The parties are in agreement that the central issue in this case is the meaning of the Agreements and that the interpretation of the Agreements is a question of law which should not be based upon extrinsic evidence. The decisions of this Court clearly provide that "whether a contract is ambiguous is a question of law which the court must decide before it takes any evidence in clarification." Morris v. Mountain States Telephone and Telegraph Co., 658 P.2d 1199, 1200 (Utah 1983) (emphasis added); see also Hibdon v. Truck Insurance Exchange, 657 P.2d 1358 (Utah 1983). Thus, this Court should look solely to the Agreements and the Deed to determine the nature and duration of the Net Profits Interest.

Atlas asserts that the trial court adhered to this standard and found, without resorting to extrinsic evidence, that the Agreements were unambiguously limited in duration. In support of this assertion, Atlas relies on a conclusory statement to that effect in the district court's Findings and Conclusions (which Atlas drafted and were adopted with little modification by

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even where the benefit is in gross. See id. at 158-69.

the district court). Atlas Brief at 47. However, although the district court made no findings of ambiguity, the Findings and Conclusions of the district court are replete with specific extrinsic evidence which is essential to the district court's construction of the Agreements.[30]

Because the district court's construction of the Agreements is at odds with the plain language used by the parties and is improperly based on extrinsic evidence, this Court should reject the district court's Findings and Conclusions and make its own determination of the meaning of the Agreements.[31] The Clovis Brief demonstrated in detail that the parties intended the duration of the Agreements and the Net Profits Interest to be tied to the duration of the Claims, Clovis Brief at 18-31, and that the terms used by the parties are unambiguous in expressing that intent. This Court, therefore, should consider only the unambiguous language of the Agreements, and reverse the summary

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[30]For example, the district court relied on extrinsic evidence that major operations did not commence immediately after closure of the Bardon Shaft; that the Interest Owners did not assert in the Yucca litigation that the Net Profits Interest had not terminated, that written notice to terminate the Bardon Mine was given to the parties' by Kerr-McGee, and that the Interest Owners did not exercise the option to take over the Bardon Mine. See Findings and Conclusions ¶¶19-24, R. 2089-91; Clovis Brief at 60-65.

[31]This Court is as capable as the district court of construing the Agreements. Betenson v. Call Auto and Equipment Sales, Inc., 645 P.2d 684, 686 (Utah 1982); see Clovis Brief at 17-18.

judgment, remanding the case to the trial court with directions to enter judgment in favor of the Clovis Banks.

B. At the Least, if the Agreements are Ambiguous the Case Must be Remanded to Allow the Trier of Fact to Resolve Genuine Issues of Material Fact.

At the very least, the summary judgment should be vacated and the case allowed to proceed to trial. If the language of the Agreements can somehow be interpreted to mean that the parties intended the Net Profits Interest not to apply to all ores mined from the Claims so long as the Claims are in effect, this Court can only conclude that the Agreements are ambiguous, i.e., "Capable of being understood in either two or more possible senses." Rainier National Bank v. Inland Machinery Co., 29 Wash. App. 725, 631 P.2d 389, 393 (1981). If the Agreements are ambiguous, the case must be remanded to the district court for the trier of fact to resolve two genuine issues of disputed material fact: (1) whether the parties intended the Net Profits Interest to be coterminous with the duration of the Claims or to be limited in duration; and (2) whether the subsequent occurrence which supposedly caused the Agreements and the Net Profits Interest to terminate actually occurred.[32]

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[32] Atlas seeks to escape these disputed issues by emphasizing that the Clovis Banks themselves argue that the Agreements are unambiguous and that the Clovis Banks also moved for summary judgment and in that connection argued that there were "no genuine issues of material fact." Atlas Brief at 47, 52-53. The argument is little better than fatuous. The Clovis Banks con-

1. If the Agreements are ambiguous, the material factual issue of the parties' intent remains to be resolved.

Atlas attempts to divert this Court's attention from the material factual issue of the parties' intent by urging that the extrinsic evidence presented by the Clovis Banks is not probative and is not factual evidence of any intent to create a perpetual interest. This argument is a misleading attempt to cloud the material issue of the parties' intent with an evaluation of the specific extrinsic evidence on the issue.

The issue of the parties' intent is clearly material because, as Atlas itself admits, the nature and duration of the Net Profits Interest is dependent wholly upon what type of interest the parties intended to create. Atlas Brief at 44. Further, if the Agreements are ambiguous, there is no basis in law to exclude any evidence of the parties' opinions, conduct and positions taken that is relevant in determining their intent and

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tended below -- and still contend -- that the Agreements are unambiguous in creating a net profits interest applicable to "all ores" mined from the Claims so long as the Claims are in effect, and thus that there is no genuine issue of fact precluding judgment in the Clovis Banks' favor. See, e.g., Response of the Clovis Banks at 19-20, 78, R. 1796-97, 1855. The Clovis Banks clearly explained below the qualified nature of their contention that no genuine and material issues exist. See Objections of Clovis Banks to Atlas' Proposed Findings of Fact at 8-9, R. 1924-25. Atlas' counsel is no doubt familiar with the phenomenon of competing motions for summary judgment, so that it is difficult to credit Atlas' apparent lack of comprehension of the Clovis Banks' position in this regard.

expectations in entering into the Agreements.[33] Indeed, in evaluating the specific extrinsic evidence of the parties' intent this Court must view all of the evidence in the light most favorable to the Clovis Banks. Clovis Brief at 18, 66.

If some of the extrinsic evidence relied upon by Atlas somehow shows an intent to limit the duration of the Net Profits Interest, the extrinsic evidence raised by the Clovis Banks is certainly sufficient to rebut that evidence and raise a genuine issue of disputed material fact concerning the parties' intent.[34] Thus, if the Agreements are ambiguous, the trier of

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[33]Atlas makes a broad leap in reasoning by asserting that because the question of "whether the AGREEMENTS are ambiguous is a question of law . . . extrinsic evidence of the parties later recollection of their subjective intent in 1957 has no probative value." Atlas Brief at 47. It is true that if the Agreements are unambiguous, the trial court should not have considered any extrinsic evidence in construing the terms. It does not follow, however, that if the Agreements are ambiguous then evidence of the parties' subjective intent is not probative of what the parties intended the contract to mean. If the Agreements are ambiguous, the trier of fact may consider all extrinsic evidence of the parties' intent, including the parties' own testimony of their subjective intentions in entering the contract. See Faulkner v. Farnsworth, 665 P.2d 1292, 1293 (Utah 1983); Rainier Nat'l Bank v. Inland Machinery Co., 29 Wash. App. 725, 631 P.2d 359 (1981); Restatement (Second) of Contracts §212 comment (1981); 3 A. Corbin, Corbin on Contracts §538, at 61-63 (1960).

[34]The fact that the parties used the term of art "Net Profits Interest" is sufficient alone to raise the factual issue of whether the parties intended those words to have a meaning other than the meaning normally attributed by the mining industry. In Universal Investment Co. v. Carpets, Inc., 16 Utah 2d 336, 338-39, 400 P.2d 564, 566 (1965), this Court held that where the contract terms had a particular meaning, the intended meaning of the terms was properly regarded as a factual dispute. It was

fact should be required to evaluate all of the extrinsic evidence, weigh any conflicting testimony, and observe the demeanor of witnesses and determine their credibility in determining the parties' intent.

2. If the district court's construction of the agreements is adopted, the material factual issue of whether the "mining venture" terminated must be resolved.

As pointed out in the Clovis Brief, Clovis Brief at 68-69, assuming arguendo that the Agreements were intended to be limited to a "specific mining venture," this construction leaves unanswered the material factual issue of whether that venture ended in 1961 (or at sometime in 1962 as Atlas now contends). Unless the evidence, viewed in the light most favorable to the Clovis Banks, compels acceptance of Atlas' factual premise, i.e., that Kerr-McGee fully explored the Claims and reached the conclusion that no further exploration was justified, this Court must reverse the summary judgment for resolution of this factual issue.

In fact, no such evidence exists. There is no letter or memorandum from Kerr-McGee indicating that further exploration was unwarranted, no oral testimony to that effect, and no written or oral statement indicating, directly or indirectly, that any of

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therefore proper for the trial court to hear testimony by experts in the field as to the generally understood and accepted meaning of the language as used in the transaction in question.

the parties to the agreements ever understood that the "mining venture" (if that concept meant anything to them) had been concluded. Rather, the evidence is to the contrary. In 1962, after the Bardon Shaft had been abandoned, Kerr-McGee explicitly declared its intention to resume exploration as soon as the accounting difficulties created by the Bardon operation could be cleaned up. Letter from Kerr-McGee to Wm. Dean McDougald (May 9, 1962), R. 1882. Although the prolongation of these accounting difficulties and Kerr-McGee's conditional assignment of the claims prevented Kerr-McGee itself from resuming operations, the Court will search the record (and the Atlas Brief) in vain for evidence that either Kerr-McGee or any of the Kerr-McGee's successors even made a determination that further exploration should not be undertaken. Moreover, as Atlas elsewhere acknowledges, Kerr-McGee retained until 1970 an option to reacquire the Claims, Atlas Brief at 12, and ultimately relinquished the option only in exchange for a very valuable production royalty in the Claims. Deed from Kerr-McGee to Foote Minerals Co., R. 1670-72. Kerr-McGee's decision to retain the option, and its acquisition of the royalty, hardly square with Atlas' bald assertion that Kerr-McGee had decided that the Claims had been "fully" explored and that further work was unwarranted. Thus, the "terminating even" upon which Atlas relies never in fact occurred.

Lacking any evidence of such termination, Atlas resorts to offuscation by emphasizing evidence showing that the parties

intended to terminate the operation on the Bardon Shaft. Atlas Brief at 52-53. No one disputes, of course, that the Bardon Shaft was abandoned; but such evidence is simply meaningless with respect to the issue in this case.[35] Richard T. Zitting, then

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[35]The Operating Agreement explicity provided in Section V for the abandonment of particular mines. In proposing the abandonment of the Bardon Shaft, Kerr-McGee specifically stated that the Operating Agreement applied to the Claims, referred to Section V and gave a precise legal description of the property to be abandoned, once again acknowledging that only part of the Claims were affected. Section V does not provide, nor did Kerr-McGee ever suggest, that abandonment of the Bardon Shaft would affect in any way the parties' rights and obligations with respect to the rest of the Claims. In its letter proposing abandonment of the Bardon Shaft, Kerr-McGee stated:

> Reference is made to that certain Operating Agreement dated April 18, 1957, entered into by and between Kerr-McGee Oil Industries, Inc., Mercury Uranium and Oil Company and . . .[the] Interest Owners; which Operating Agreement pertains to the following described unpatented lode mining claims, to-wit:
>
> Velvet Claims 1-34, inclusive
> Royal Flush Claims 1-4, inclusive
> . . . .
>
> Pursuant to Article V of said Operating Agreement, notice is hereby given to you that Kerr-McGee Oil Industries, Inc. and Anderson Development Corporation by mutual agreement now desire to abandon the mine and the working in connection therewith located on and servicing that part (said part being the area desired to be abandoned) of the lands covered by the above described claims more particularly described as follows, to-wit:
>
> A tract of land situated in the NW/4 of Section 3, T. 31 S., R. 25 E., Salt Lake Meridian, San Juan County, Utah more fully described as follows:
>
> Commencing at a point 125 feet due south from the

Kerr-McGee's Manager of Mineral Exploration, has stated under oath that neither he nor any of the other parties ever believed or intended that the Net Profits Interest would terminate upon the winding up of the Bardon Shaft operation.[36]

Like its proposed construction of the Agreements, Atlas' position on the material factual issue of termination is hopelessly contradictory. Atlas cannot even consistently describe, let alone support, the version of the facts that it would like the Court to accept, and thus admits that factual issues remain. Though the reasons for the district court's ruling are admittedly obscure, the ruling is itself clear in at least two particulars. The district court certainly ruled, first, that the

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> NW corner Section 3, T. 31 S., R. 25 E., thence due east 650 feet to NE corner of said tract; thence due south 500 feet to SE corner of said tract; thence due west 650 feet to SW corner of said tract; thence due north 500 feet to NW corner of said tract, the point of beginning.

Letter from Kerr-McGee to Interest Owners (Dec. 19, 1962), R. 1606-07 (emphasis added).

[36] See Affidavit of Richard T. Zitting, R. 1771-73. The abandonment of the Bardon Shaft is perhaps relevant to the issue in this case in one respect. The correspondence between Kerr-McGee and the Interest Owners shows that when the parties desired to terminate or abandon something, they knew how to do so. Kerr-McGee's letter abandoning the Bardon Shaft is clear and precise in identifying the authorizing provision and in explaining the legal effect of the abandonment. Any similar letter or statement declaring Kerr-McGee's supposed decision that further exploration was unjustified, or even hinting at any such decision, is conspicuously non-existent.

Net Profits Interest terminated in 1961, and, second, that the event triggering this termination was the abandonment of the Bardon Shaft.[37] This scenario, however, is not only without support in the record -- Atlas cites no evidence even suggesting that all of the Claims had been "fully," or even significantly, explored by the end of 1960 -- but is decisively refuted by Kerr-McGee's unequivocal declaration in 1962, more than a year after all operations had supposedly been wound up, that further exploration was planned.[38] Attempting to cope with this fact, Atlas discreetly waits in its brief for 27 pages and then, completely abandoning both its own earlier position and the district court's ruling, proposes a wholly new scenario: Kerr-McGee's supposed decision to discontinue exploration on the claims did not occur before 1961 after all; rather, it must have happened "some time near December 31, 1962." Atlas Brief at 50 n. 142.

Thus, Atlas' own inconsistencies show that a dispute exists as to facts that are essential to the district court's

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[37] Findings and Conclusions ¶¶ 38, 39, 41, 42, R. 2097 - 2103. Atlas makes occasional attempts to defend this ruling, arguing at one point that by the time the Bardon Shaft was abandoned in late 1960 or early 1961, Kerr-McGee had already fully explored the remaining claims, so that no further operations were contemplated after the Bardon operation was wound up. Atlas Brief at 23 n. 76.

[38] See Letter from Kerr-McGee to Wm. Dean McDougald (May 9, 1962), R. 1882; Clovis Brief at 9-10.

ruling. Whichever of Atlas' factual scenarios this Court might choose to consider, if the Agreements are ambiguous, the evidence shows that disputed material factual issues exist. This Court, therefore, at the least must remand the case for the trier of fact to resolve these genuine and material factual issues.

CONCLUSION

The new arguments and theories raised by Atlas in its brief cannot support the district court's ruling. As shown in the Clovis Brief and in this Reply, this Court should reverse the district court's ruling and remand the case with instructions to enter summary judgment in favor of the Clovis Banks.

Respectfully submitted this 30th day of November, 1983.

Attorneys for The Clovis National Bank and The Citizens Bank of Clovis

MODRALL, SPERLING, ROEHL, HARRIS & SISK
Allen C. Dewey, Jr., Esq.

ROOKER, LARSEN, KIMBALL & PARR
Dale A. Kimball, Esq.
Stephen J. Hull, Esq.
Ronald G. Russell, Esq

By Dale A. Kimball

CERTIFICATE OF SERVICE

I certify that three copies of Reply Brief of Appellants were mailed first class, postage prepaid, this 30th day of November, 1983 to the following:

Stephen D. Alfers
William A. Hillhouse
David R. Hammond
Eliza C. Finkenstaedt
Davis, Graham & Stubbs
P. O. Box 185
2600 Colorado National Building
Denver, Colorado 80201

I also certify that a copy of Reply Brief of Appellants was mailed first class, postage prepaid, this 30th day of November, 1983 to the following:

L. Robert Anderson
Lyle R. Anderson
Anderson & Anderson
P. O. Box 275
Monticello, Utah 84535

Nancy M. Wetherell