



10 of 16 DOCUMENTS

**CORNERSTONE OIL COMPANY, Petitioner and Appellant, v. STOCKER
RESOURCES and PLAINS EXPLORATION & PRODUCTION COMPANY,
Respondents.**

B183950

**COURT OF APPEAL OF CALIFORNIA, SECOND APPELLATE DISTRICT,
DIVISION SEVEN**

2006 Cal. App. Unpub. LEXIS 10919

December 4, 2006, Filed

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PRIOR HISTORY: APPEAL from a judgment of the Superior Court of Los Angeles County, No. SS012435. John L. Segal, Judge.

DISPOSITION: Affirmed.

COUNSEL: Sullivan, Workman & Dee and Joseph S. Dzida for Plaintiff and Appellant.

Manatt, Phelps & Phillips and Mark D. Johnson for Respondents.

JUDGES: WOODS, J.; JOHNSON, Acting P.J., ZELON, J. concurred.

OPINION BY: WOODS

OPINION

Appellant Cornerstone Oil Company (Cornerstone) brought a petition for declaratory relief to determine the right to receive income from the oil and gas produced from three parcels located in Los Angeles County. After an examination of the record and documents on which the claims are predicated this court concludes the judgment has correctly defined the rights of the parties to participate in royalties. We affirm.

FACTUAL AND PROCEDURAL BACKGROUND

Atlantic Richfield Company (ARCO) acquired by deed the land that [*2] is the subject of this action. That land, including surface and underground mineral rights, consists of Parcels 1, 2 and 3 located in the County of Los Angeles with an aggregate area of approximately one acre.¹ ARCO was the original lessor under three separate subsurface oil and gas leases and was the original holder of the royalty interest (RI) in the three parcels. As is common in the industry,

ARCO gave its consent to the lessee in each parcel the right to combine and pool the land covered by these leases with other land to form oil and gas production units. The royalty payment due to the lessor would be based on the ratio or proportion of the area of land covered by lease to the total area of land covered by the production unit and based on the total amount of oil and gas produced.

1 Parcel 1 is located on the south side of Pico Boulevard in the City of Los Angeles. Parcel 2 is located on Robertson Avenue south of Burton Way in the City of Beverly Hills. Parcel 3 is on the south side of Pico Boulevard in the City of Beverly Hills. Each parcel has a corresponding lease associated with the parcel. Lease 1(b) affects Parcel 1, Lease 2 affects Parcel 2, and Lease 3 affects Parcel 3.

[*3] Respondents are Stocker Resources and Plains Exploration & Production Company. Respondents, as successor lessees, must make royalty payments to the current holder of the RI. Appellant Cornerstone contends that it succeeded to ARCO's lessor interest and that it holds the RI. Respondents disagree, and contend that Columbine II Limited Partnership (Columbine) acquired the RI from ARCO.

Respondents initially suspended RI payments to Columbine then resumed them when Columbine agreed to indemnify them from Cornerstone's claim. The interests of respondents and Columbine, therefore, are identical for purposes of this appeal. Both Cornerstone and Columbine claim the RI through ARCO.

The ARCO-Aviva/Columbine transaction

Pursuant to a purchase and sale agreement dated August 11, 1992, ARCO sold to Aviva, Inc. (Aviva) for \$ 27 million the royalty interests, unitized interests and other oil and gas interests in properties covering several western states. The properties sold included the three parcels that are the subject of this appeal. In accordance with Exhibit B of the agreement and as a result of the pooling of land covered by the parcels, the interests sold included ARCO's unitized [*4] interest or "UI" in the Crescent Heights Unit and the West Salt Lake Unit, units which include the three parcels. As indicated, unitization or pooling allows for the drilling of oil into the pool underlying an entire unit rather than within the boundaries of the particular leasehold. The agreement defined UI as a "royalty interest, overriding royalty interest, net profit interest, or other non-cost bearing interest which has been unitized, communitized or pooled under unit, communitization, pooling or similar agreements, or under orders of state or federal regulatory agencies." ARCO reserved "any executive right, or reversionary mineral fee interest or servitude of ARCO, its successors and assigns."

On July 14, 1993, a document entitled Assignment and Conveyance (the Original Assignment) was recorded in which ARCO assigned to Columbine, an entity affiliated with or related to Aviva, the interests identified in an attached Exhibit A to the Original Assignment. Corrections were made and ultimately a Fourth Corrected Assignment and Conveyance was recorded in Oklahoma on October 31, 1994, and in Los Angeles County on February 16, 1995. Pursuant to the Fourth Corrected Assignment, ARCO [*5] assigned to Columbine the interests identified in the attached Exhibit A. The interests included a UI or unitized interest in the three parcels. The Fourth Corrected Assignment, which was to correct and clarify certain descriptions set forth in the Original Assignment, stated:

"Assignor [ARCO] hereby grants, bargains, sells and conveys to Assignee [Columbine], . . . all of [ARCO]'s right, title and interest in and to the following:

"(a) [ARCO]'s right, title and interest in and to or derived under (i) the royalty interest reserved in favor of [ARCO] or its predecessor(s) in title, as lessor in any oil and gas lease or oil, gas, and mineral lease in which [ARCO] or its predecessor(s) in title is the lessor and which covers property as described in Fourth Corrected Exhibit A hereto, or any part thereof or any interest therein; (ii) the royalty interest, non-participating royalty interest or non-executory mineral interest either granted to or reserved by or in favor of [ARCO] or its predecessor(s) in title in any deed, grant, or conveyance in which [ARCO] or its predecessor(s) in title is either the grantor or grantee and which covers property as described in Fourth [*6] Corrected Exhibit A hereto, or any part thereof or any interest therein; (iii) each overriding royalty interest, net profit interest or other non-cost bearing interest either granted to or reserved by or in favor of

[ARCO] or its predecessor(s) in title in any assignment or conveyance in which [ARCO] or its predecessor(s) in title is either the assignor or assignee and which covers property as described in Fourth Corrected Exhibit A hereto, or any part thereof or any interest therein; and (iv) without limitation of the foregoing, each royalty interest, overriding royalty interest, net profit interest or other non-cost bearing interest which has been unitized, communitized or pooled under unit, communitization, pooling or similar agreements, or under orders of state regulatory agencies, and which unitized, communitized or pooled interest covers property as described in Fourth Corrected Exhibit A hereto, or any part thereof or any interest therein, INsofar AND ONLY INsofar AS (but without limitation of the provisions of subsection (iv), above) each Additional Royalty Interest (as hereinafter defined) covers or relates to the lands and other property described in Fourth Corrected [*7] Exhibit A under the heading 'Description of Lands.'"

The interests identified in Exhibit A of the Fourth Corrected Assignment and Conveyance included the UI or unit interest in the three parcels which are part of the Crescent Heights Unit and West Salt Lake Unit. Exhibit A defines a UI or unit interest as "a royalty interest, overriding royalty interest, net profit interest, or other non-cost bearing interest which has been unitized, communitized or pooled under unit, communitization, pooling or similar agreements, or under orders of state or federal regulatory agencies."

The ARCO-Cornerstone Transaction

On November 16, 1995, a mineral deed from ARCO to Cornerstone was recorded in Los Angeles County. Cornerstone paid ARCO \$ 36,500 for all of ARCO's "right, title and interest in and to all the oil, gas and other minerals that may be produced from the lands described in Exhibit 'A' attached hereto." Exhibit A listed, among others parcels, the three parcels that are the subject of this appeal. However, ARCO's rights, title and interest in the three parcels were conveyed "subject to" the earlier Aviva/Columbine conveyances and subject to any prior agreements.

Moreover, the [*8] mineral deed conveyed the parcels on an "AS IS" basis, "WITH ALL FAULTS" and without representations or warranties which might affect the interests being conveyed. Specifically Exhibit A attached to and made part of the mineral deed between ARCO and Cornerstone lists the parcels in question as being "subject to Assignment and Conveyance between [ARCO] and [Columbine], effective July 1, 1992."

On February 20, 1996, Cornerstone wrote to Columbine and stated "We recently purchased the mineral fee in 1,332 properties from ARCO, and we were surprised to find after the fact that four of the properties we had purchased were ones where *ARCO had previously sold the royalty interest to Columbine.*" (Italics added.) The letter identifies each of the three parcels in issue here. Also, the letter from Cornerstone offers to "purchase Columbine's *royalty interest* so that ownership in both the fee and the royalty will be uniform." (Italics added.) Thus, at the time Cornerstone made its purchase, there was a recorded Fourth Corrected Assignment and Conveyance which clearly identified ARCO's royalty interest in the three parcels as being conveyed to Columbine and to which Cornerstone [*9] had notice.

Cornerstone filed a petition for declaratory relief to invalidate the three leases affecting the three parcels and to determine the right to receive royalty income. Cornerstone contended it, rather than Columbine, acquired ARCO's interest as lessor under the three leases and the leases terminated because respondent Plains failed to pay Cornerstone, as ARCO's successor, the amount owed under the leases.

Respondent Plains answered the petition then sought to resolve the action by summary judgment based on the plain meaning of the documents. The trial court denied summary judgment finding terms in the documents to be ambiguous and requiring parol evidence to understand and interpret the relevant language.

After a bench trial lasting several days, the court ruled in favor of Plains based on the language of relevant documents, the testimony of witnesses at trial, and Cornerstone's admission that Columbine acquired the royalty interests in the parcels.

The trial court found that ARCO's interest in the parcels had become unit interests and those interests were transferred to Columbine. Furthermore, it reasoned that when Cornerstone acquired its interests in the parcels it [*10]

had notice of the previous transfer to Columbine as shown in the language of the deed. Also the trial court specifically found the Cornerstone offer to be an admission by Cornerstone of the previous transfer by ARCO to Columbine, and therefore whatever interest Cornerstone acquired was subject to Columbine's interest.

The trial court entered judgment against Cornerstone and Cornerstone timely appealed.

DISCUSSION

Contentions on Appeal

On appeal, Cornerstone contends the conveyance between ARCO and Columbine involving the three parcels did not list ARCO's royalty interests (RI) in the subject leases but rather only conveyed the unitized interests (UI) and that the trial court erred in holding that a conveyance of the UI also transferred the RI.

Standard of Review

A trial court's threshold determination as to whether there is an ambiguity permitting the admission of parol evidence is a question of law subject to independent legal review. (*Fischer v. First International Bank* (2003) 109 Cal.App.4th 1433, 1443.)

"The standard of review of the trial court's ultimate determination of the construction of the ambiguous language depends on the [*11] circumstances. If the parol evidence is in conflict, requiring the resolution of credibility issues, we would be guided by the substantial evidence test. (*Stratton v. First Nat. Life Ins.* (1989) 210 Cal.App.3d 1071, 1084, 258 Cal. Rptr. 721.) However, where the extrinsic evidence is not in conflict, construction of the agreement is a question of law for our independent review. (*Parsons v. Bristol Development Co.* (1965) 62 Cal.2d 861, 865, 44 Cal. Rptr. 767.)" (*Appleton v. Waessil* (1994) 27 Cal.App.4th 551, 554-555.) Here, the conflicting evidence included the credibility of the witnesses and Cornerstone's admissions in parol evidence that support the trial court's ruling.

I. The trial court properly considered extrinsic evidence concerning the meaning of the underlying documents and found ARCO transferred its RI in the parcels and that the conveyances of the UI were included in the RI

Appellant argues the underlying documents only conveyed unitized interests to Columbine because ARCO explicitly conveyed the UI to Columbine and the documents clearly reflect the parties' intent to convey only particular interests as specified. [*12] We disagree.

Appellant relies on *Public Resources Code section 3656* to argue the creation of a unit does not automatically change any title and must not be construed to automatically change any title. *Public Resources Code section 3656* states "No unit agreement . . . shall effect or result in, or be construed to effect or result in, the alienation, transfer, or change of any title or ownership, legal or equitable, of any person or property in or to any tract of land or the mineral rights therein to any person or party."

The testimony of witnesses at trial established that ARCO had a lessor's royalty interest in the leases and that the creation of the Crescent Heights Unit and the West Salt Lake Unit converted ARCO's lessor royalty interest in these units to unitized interests. The witnesses also explained the key difference relates to the basis for the amount of royalty payments due to ARCO. Specifically, once the land was combined with other lands to form a unit, then the basis for compensation owed to ARCO changed and was based on the amount of oil and gas produced for the unit as a whole. As a result, it was logical and necessary [*13] for the Original Assignment and the Fourth Corrected Assignment to describe the interest assigned to Columbine as a UI or unit interest. References to these parcels as UI or unit interests were necessary to determine the amount owned based on the amount of land covered by each.

Furthermore, before the transactions, ARCO had a landowner's or lessor's royalty interest in the leases and also held a reversionary interest in the mineral fee of the parcels. "Under the usual oil and gas lease the owner confers on the

lessee for the term of the lease an exclusive right of profit to drill for and produce oil, the lessee usually returning to the lessor for the privilege granted a rent or royalty measured by a fraction of the oil produced." (*Dabney-Johnston Oil Corp. v. Walden* (1935) 4 Cal.2d 637, 649.) Typically, "[i]n addition to the right to receive rent or royalty, the lessor has a reversionary interest in the right to drill for and produce oil, dependent upon the termination of the existing leasehold, which right is the subject of grant." (*Id. at p. 651.*) The rights typically held by a lessor under an oil and gas lease are the same as the rights held [*14] by ARCO in Leases 1(b), 2 and 3 and Parcels 1, 2 and 3 respectively. This reversionary interest meant that on termination of the leases ARCO would revert to having an interest in the parcels free of obligations or restrictions imposed by the leases. When the lands were combined with other land to form units, ARCO's interest in the leases converted to a UI or lessor's royalty interest in the units. Exhibit A defines RI or royalty interest as an interest "reserved in favor of Assignor or its predecessor(s) in title, as lessor, in an oil and gas lease or an oil, gas and mineral lease in which Assignor or its predecessor(s) in title is the lessor." This definition is consistent with the finding that the royalty interest included the unitization interests relating to the three parcels.

Moreover, considering the underlying documents as a whole it is clear ARCO intended to convey its entire royalty interest in the parcels. Description of the parcels as UI allowed the parties to recognize this interest as part of a broader unitized pool. The intent of ARCO to limit the rights of Cornerstone were clearly and unequivocally indicated when the interests were transferred "subject to" the Original [*15] Assignment to Columbine which became the Fourth Corrected Assignment. Also, Cornerstone's offer to purchase Columbine's *royalty interest* in the parcels, demonstrates an admission by Cornerstone that Columbine owned the royalty interests.

The Fourth Corrected Assignment was recorded February 16, 1995, nine months *before* the recordation of the Cornerstone Assignment and Deed on November 16, 1995. Therefore Cornerstone was on actual and constructive notice of Columbine's interest in the parcels. As a result, the trial court correctly found that ARCO transferred to Columbine its royalty interest in the leases including the unitized interests in the Crescent Heights Unit and the West Salt Lake Unit, and that Cornerstone was not entitled to receive any payments under the leases.

In sum, substantial evidence was presented for the trial court to conclude that Plains was the lessee under the leases which are valid and remain in effect, Cornerstone was not entitled to receive any payments with respect to any oil and gas produced from the parcels, and ARCO transferred its lessor's royalty interest and related unitized interests in the parcels to Columbine, not Cornerstone.

DISPOSITION

[*16] The judgment is affirmed. Respondents to recover costs on appeal.

WOODS, J.

We concur:

JOHNSON, Acting P.J.

ZELON, J.