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## Oil, Gas and Mineral Law

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# OIL, GAS AND MINERAL LAW

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## TABLE OF CONTENTS

I. CONVEYANCING ISSUES.....	1423
A. RESERVATION OF MINERALS .....	1423
B. ASSIGNMENTS OF MINERAL INTERESTS .....	1429
II. OIL, GAS AND MINERAL LEASES .....	1432
A. LEASE COVENANTS .....	1432
B. SURFACE/MINERAL RELATIONSHIP .....	1443
C. ROYALTY INTERESTS .....	1444
III. JOINT OPERATIONS .....	1446
IV. GAS TRANSPORTATION CONTRACTS .....	1450

**T**HIS Article focuses on the interpretations of, and changes relating to, oil, gas and mineral law in Texas from October 1993 through September 1994. The cases examined include decisions of courts of the State of Texas and the Fifth Circuit Court of Appeals.<sup>1</sup>

### I. CONVEYANCING ISSUES A. RESERVATION OF MINERALS

*Dickens v. Harvey*<sup>2</sup> involved the 1982 conveyance, from Rutten to Harvey, of 50 acres out of a 1162 acre tract, reserving “all mineral reservations, royalty reservations and/or mineral leases” in Rutten’s chain of title. The deed also stated: “No Minerals are transferred by this Deed.” Rutten had previously executed, in 1977, a coal and lignite lease on the property and, sometime after 1982, had divided ownership of the minerals under the tract among Dickens and others (collectively, “Dickens”).

In 1992, ten years after the conveyance to Harvey, Harvey sued Dickens, asking the lower court for a declaratory judgment that his 1982 deed conveyed, as part of the surface estate, the coal and lignite. Dickens counterclaimed for reformation of the deed, claiming that the failure of

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1. This article is devoted exclusively to Texas law. Cases involving questions of oil, gas and mineral law, decided by courts sitting in Texas but applying laws of other states, are not included.

2. 868 S.W.2d 436 (Tex. App.—Waco 1994, no writ).

the 1982 deed to expressly reflect a reservation of the coal and lignite to Rutten was the result of mutual mistake.

Both Harvey and Dickens moved for summary judgment. The lower court granted summary judgment for Harvey, declaring that: the 1982 deed to Harvey did, as a matter of law, convey the coal and lignite as part of the surface estate; the reservation clause did not reserve any right, title or interest in the coal and lignite to Rutten; and Dickens was not entitled to reformation of the deed. The lower court denied Dickens' motion for summary judgment that, without regard to the ownership of the coal and lignite, the 1982 deed reserved, as a matter of law, the royalty interest under the 1977 coal and lignite lease.

Relying on *Acker v. Guinn*,<sup>3</sup> the Waco Court of Appeals held that a grant or reservation of minerals or mineral rights is not to be construed to include a substance that must be removed by methods that will consume or deplete the surface estate unless a contrary intention is affirmatively and fairly expressed.<sup>4</sup> The court then discussed the amplification of that rule in later decisions of the Texas Supreme Court. It cited *Reed v. Wylie*<sup>5</sup> (*Reed I*), for the rule that the use of the word "mineral" in an instrument is not construed to include the near surface substances absent an expression of that intent; and *Reed v. Wylie*<sup>6</sup> (*Reed II*) for the rule that coal and lignite deposits within 200 feet of the surface are "near surface" as a matter of law.<sup>7</sup> The court describes the two-pronged test of *Reed II* as follows: "[A] person claiming ownership of coal and lignite as part of the surface estate must prove either (1) that the substances lie within 200 feet of the surface or (2) that their mining may substantially impair or destroy the surface."<sup>8</sup>

The Waco court found that because the 1982 deed to Harvey stated no express intention with respect to coal and lignite, it must apply the two-pronged *Reed II* test.<sup>9</sup> Finding that neither prong of the test had been satisfied by Harvey, and that material issues of fact existed with respect to where the coal and lignite were located and the impact of mining on the surface, the court reversed the summary judgment insofar as it found that the coal and lignite had been conveyed to Harvey as a matter of law, and remanded to the lower court for further proceedings.<sup>10</sup>

The Waco court then addressed Dickens' counterclaim for reformation of the deed to expressly reserve the coal and lignite from the conveyance

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3. 464 S.W.2d 348 (Tex. 1971).

4. *Dickens*, 868 S.W.2d at 439.

5. 554 S.W.2d 169, 170-71 (Tex. 1977).

6. 597 S.W.2d 743 (Tex. 1980).

7. *Dickens*, 868 S.W.2d at 439.

8. *Id.* (citing *Reed II*, 597 S.W.2d at 747-48).

9. *Id.*

10. *Id.* at 439-40. The court also briefly addressed Harvey's argument that the 1972 contract for sale underlying the 1982 conveyance required Rutten, as a matter of law, to convey the coal and lignite. It stated that although Rutten might be subject to a suit for breach of contract or reformation, he was not constrained from conveying the property in a manner contrary to a contract for sale. *Id.* at 439.

to Harvey. Holding the claim to be time-barred, it affirmed the summary judgment that Dickens take nothing.<sup>11</sup> The court cited *Sullivan v. Barnett*<sup>12</sup> for the rule that a grantor is charged with knowledge of all defects in a deed, and *Latham v. Richey*<sup>13</sup> for the rule that absent evidence of an exception to the former rule, the four-year statute of limitations for reformation of a deed begins to run on the date of the deed's execution.<sup>14</sup> While noting that mutual mistake is generally an exception to the rule of immediate knowledge,<sup>15</sup> the court was persuaded by Harvey's summary judgment evidence that Rutten knew of the mistake, if one existed, no later than 1986.<sup>16</sup> Consequently, the claim for reformation by Rutten's successors, brought in 1992, had been time-barred since 1990.<sup>17</sup>

Finally, the Waco court reversed the lower court's denial of Dickens' motion for summary judgment that, regardless of the ownership of the lignite under Harvey's acreage, the 1982 deed reserved to Rutten, as a matter of law, the royalties under the 1977 lignite lease.<sup>18</sup> Distinguishing the issue of whether the 1982 deed conveyed coal and lignite as minerals, from the issue of whether the parties intended the terms "royalty reservations" or "mineral leases" to include the royalty under the 1977 lease, the court held the rules of *Reed II* to be inapplicable.<sup>19</sup> Applying general rules for interpreting deeds,<sup>20</sup> the Waco court found the use of the term "royalty reservation" in the reservation clause to unambiguously reserve to Rutten the royalty under the 1977 coal and lignite lease.<sup>21</sup>

In *French v. Chevron USA, Inc.*,<sup>22</sup> the court of appeals in El Paso was asked to decide whether a deed conveyed a mineral interest with reservations, or conveyed a royalty interest.<sup>23</sup> Affirming the summary judgment of the lower court, the appellate court held that the deed transferred a mineral interest with reservations.<sup>24</sup>

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11. *Id.* at 440.

12. 471 S.W.2d 39, 45 (Tex. 1971).

13. 772 S.W.2d 249, 253 (Tex. App.—Dallas 1989, writ denied).

14. *Dickens*, 868 S.W.2d at 440.

15. *Id.* (citing *Brown v. Harvard*, 593 S.W.2d 939, 944 (Tex. 1980)).

16. *Id.* at 441.

17. *Id.* The court relied on the fact that Rutten had been sued twice in 1986, in separate lawsuits, on deeds and contracts virtually identical to the deed to Harvey and in which the same or similar issues were raised. In one suit, Rutten had even counterclaimed for reformation of the deed on the same legal basis pleaded by him in this action. Although the two suits involved different parties and properties, the court found that Rutten had knowledge of any mutual mistake, as a matter of law, no later than 1986. *Id.*

18. *Id.*

19. *Id.* at 442.

20. *Id.* (citing *Martin v. Schneider*, 622 S.W.2d 620, 621 (Tex. App.—Corpus Christi 1981, writ ref'd n.r.e.)). The court cited *Texas Co. v. Meador*, 250 S.W. 148, 150 (Tex. Comm'n App. 1923, judgment adopted), as holding that "royalty" and "royalty reservations" have well-defined meanings, and must be given those meanings, unless a contrary meaning is indicated by the context. *Id.*

21. *Id.*

22. 871 S.W.2d 276 (Tex. App.—El Paso 1994, writ granted).

23. *Id.* at 277.

24. *Id.* The lower court found the deed to be unambiguous and this ruling was not appealed.

The deed at issue read, in part, as follows:

That I, GEORGE CALVERT, . . . do grant, bargain, sell, convey, set over, assign and deliver unto CAPTON M. PAUL, an undivided Fifty (50) Acre interest, being an undivided 1/656.17th interest in and to all of the oil, gas and other minerals, in, under and that may be produced from the following described lands, situated in Crane and Ward Counties, State of Texas. . . .

It is understood and agreed that this conveyance is a royalty interest only, and that neither the Grantee, nor his heirs or assigns shall ever have any interest in the delay or other rentals or any revenues or monies received or derived or to be received or derived from the leasing of said lands present or future or any part thereof, or the renewal or extension of any lease or leases now on said lands or any part thereof. Neither the Grantee herein nor his heirs or assigns shall ever have any control over the leasing of said lands or any part thereof or the renewal or extending of any lease thereon or for the making of any lease contract to develop or prospect the same for oil, gas or other minerals, which is hereby specifically reserved in the Grantor.<sup>25</sup>

The El Paso court first described the five essential attributes of a mineral estate in Texas: (1) the right to develop; (2) the right to lease; (3) the right to receive bonus payments; (4) the right to receive delay rentals; and (5) the right to receive royalty payments.<sup>26</sup> The court then cited *Extraction Resources, Inc. v. Freeman*<sup>27</sup> for the rule that each attribute constitutes an independent property right, may be severed into a separate interest, and may be separately conveyed or reserved by the owner,<sup>28</sup> and *Prairie Producing Co. v. Schlachter*,<sup>29</sup> for the rule that when a mineral owner conveys a mineral estate, all attributes are impliedly transferred unless specifically reserved to the grantor.<sup>30</sup>

In holding that the deed conveyed a mineral interest with reservations rather than royalty, the appellate court relied upon *Altman v. Blake*<sup>31</sup> for the rule that a deed provision reserving certain rights did not change the character of a conveyance from a mineral estate to a royalty interest.<sup>32</sup> According to the El Paso court, under *Altman*, the words "this conveyance is a royalty interest only" cannot serve to create a royalty interest without an express reference to royalties for actual production of minerals, words which were missing in the deed at issue.<sup>33</sup> In addition, the court cited a number of Texas cases decided prior to *Altman* for the rule that a deed must refer to production in order to convey a royalty inter-

25. *Id.* (emphasis added).

26. *Id.* (citing *Altman v. Blake*, 712 S.W.2d 117, 118 (Tex. 1986), citing R. HEMMINGWAY, LAW OF OIL AND GAS, §§ 2.1-2.5 (1971)).

27. 555 S.W.2d 156, 158-59 (Tex. Civ. App.—El Paso 1977, writ ref'd n.r.e.).

28. *French*, 871 S.W.2d at 278.

29. 786 S.W.2d 409, 412 (Tex. App.—Texarkana 1990, writ denied).

30. *French*, 871 S.W.2d at 278.

31. 712 S.W.2d 117 (Tex. 1986).

32. *French*, 871 S.W.2d at 278.

33. *Id.* at 278-79.

est.<sup>34</sup> Finally, the court relied upon the fact that the deed expressly reserved leasing rights and delay rentals, noting that since royalty interests do not carry these rights, there would have been no reason to reserve them had the conveyance of a royalty interest been intended.<sup>35</sup>

*Concord Oil Co. v. Pennzoil Exploration & Prod. Co.*<sup>36</sup> involved the interpretation of a 1937 "two-grant deed"<sup>37</sup> which contained a granting clause conveying a 1/96 mineral interest and a subject-to clause describing a 1/12 royalty interest in existing leases. The deed did not contain a clause dealing with future leases. The primary issue was whether the deed conveyed a 1/96 mineral interest, which was less than what the grantor owned, or a 1/12 mineral interest, which was the full interest of the grantor. The court held that the deed conveyed only part (1/96) of the grantor's interest in the minerals, but all (1/12) of the grantor's interest in the royalty under then existing leases.<sup>38</sup>

On August 5, 1937 A. B. Crosby executed a deed to Southland Lease & Royalty Corporation which provided:

That I, A.B. Crosby . . . do Grant, Sell and Convey unto Southland . . . an undivided . . . (1/96) interest in and to all of the oil, gas and other minerals. . . .

. . . .  
While the estate hereby conveyed does not depend upon the validity thereof, neither shall it be affected by the termination thereof, this conveyance is made subject to the terms of any valid subsisting oil, gas and/or mineral lease or mineral lease or leases on above described land or any part thereof, but covers and includes . . . (1/12) of all rentals and royalty of every kind and character that may be payable by the terms of such lease or leases. . . .

In 1961 Pennzoil Exploration and Production Company and others received from Crosby a conveyance of a 7/96 mineral interest. Concord Oil Company succeeded to the rights of Southland.<sup>39</sup>

Concord argued that its predecessor in title, Southland, conveyed all of Crosby's mineral interest as well as all of his royalty interest in existing leases. Concord's argument was that under the "oil and gas notions that prevailed during the 1920's and 1930's . . ." the parties used the fraction of 1/96 to describe what portion of the oil and gas then being produced was received by Crosby, which was "1/12 of 1/8 provided under the ex-

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34. *Id.* (citing *Watkins v. Slaughter*, 144 Tex. 179, 189 S.W.2d 699 (1945); *Grissom v. Guetersloh*, 391 S.W.2d 167, 168 (Tex. Civ. App.—Amarillo 1965, writ ref'd n.r.e.); *Etter v. Texaco, Inc.*, 371 S.W.2d 702, 706 (Tex. Civ. App.—Waco 1963, writ ref'd n.r.e.)).

35. *Id.*

36. 878 S.W.2d 191 (Tex. App.—San Antonio 1994, writ granted)

37. The court described a "three-grant deed" as one "with three blanks to be filled in: one in the granting clause, one in the subject-to clause pertaining to existing leases, and one in the future-lease clause." *Id.* at 193.

38. *Id.* at 196. The court also held that the subject-to clause did not grant a full 1/12 interest in future leases, and that the deed was unambiguous which precluded extrinsic evidence of intent. *Id.* at 197.

39. *Id.* at 192.

isting lease."<sup>40</sup> Although the court is not clear on the point, Concord's argument apparently was that the uncertain state of mineral law during that period, frequently chronicled by scholars and practitioners, together with the circumstances of this transaction and the deed itself, demonstrated that the deed was ambiguous as to what mineral interest was intended to be conveyed.<sup>41</sup>

The court acknowledged the historical context in which the deed was written and agreed that "most parties mean for . . . [a mineral] deed to convey a single fractional interest in the minerals, the existing lease, and future leases."<sup>42</sup> The court also agreed that the multiple-grant deeds derived, not from a desire of the parties to convey different estates within the same instrument, but from a misguided court decision, *Carruthers v. Leonard*,<sup>43</sup> which held that "a mineral deed did not convey an interest in delay rentals (or presumably, the royalties) under an existing lease unless there was express language of assignment."<sup>44</sup>

The court held, however, that parties may convey different fractional interests in one instrument,<sup>45</sup> and that in this case, the deed did convey different fractional interests in the minerals and royalty. The court's reasoning was that a "two-grant deed", which could be read within the "four corners"<sup>46</sup> and which contained no future lease clause, traditionally had been held to convey separate estates, and that "[t]he public interest in certainty of land titles is overriding and paramount."<sup>47</sup>

The court cited *Garrett v. Dils Co.*<sup>48</sup> and *Pan American Petroleum Corp. v. Texas Pac. Coal & Oil Co.*<sup>49</sup> in support of its conclusion that

40. *Id.* at 193.

41. Although the court states that it did not consider extrinsic evidence, it notes that the conveyance to Crosby one day before, on August 4, 1937 conveyed 1/12 of the minerals and 1/12 of the royalty. *Id.* at 196 n.7.

42. *Id.* at 194 (citing Ernest E. Smith, *The "Subject To" Clause*, 30 ROCKY MTN. MIN. L. INST. § 15.02[1] (1985); Laura H. Burney, *The Regrettable Rebirth of the Two-Grant Doctrine in Texas Deed Construction*, 34 S. TEX. L. REV. 73, 91 (1993); Terry I. Cross, *Conveyancing—From Repugnance to Harmony—The Demise of Alford v. Krum*, in STATE BAR OF TEXAS PROF. DEV. PROGRAM, ADVANCED OIL, GAS AND MINERAL LAW COURSE F, F-1 (1992)).

43. 254 S.W. 779 (Tex. Comm'n App. 1923, judgment adopted).

44. *Concord Oil*, 878 S.W.2d at 193. But it should be noted that in *Carruthers*, the court held that delay rentals were not included in the conveyance of the minerals, but were instead "paid for the privilege of drilling anywhere on the surface of the land . . . and did not arise from . . . any of the minerals in which . . . [the mineral purchaser] . . . bought a one-half interest, and is not, in any manner, connected with those minerals." *Carruthers*, 254 S.W. at 782-83. It is doubtful, therefore, whether the *Carruthers* court would have recognized a transfer of delay rentals by anyone other than the surface owner. See also *Harris v. Currie*, 142 Tex. 93, 176 S.W.2d 302, 306 (1943), in which the Texas Supreme Court overruled *Carruthers*, stating that the proposition that delay rentals were owned by the surface owner "was clearly erroneous, as . . . [the mineral owner] had every right to the surface of this land necessary to enforce and enjoy his mineral title that . . . [the surface owner] had for the same purpose." *Id.* at 306.

45. *Concord Oil*, 878 S.W.2d at 192.

46. *Id.* at 194.

47. *Id.* at 195.

48. 157 Tex. 92, 299 S.W.2d 904 (1957).

49. 340 S.W.2d 548 (Tex. Civ. App.—El Paso 1960, writ ref'd n.r.e.).

there has existed a "two-grant theory of interpreting deeds"<sup>50</sup> which "has been part of Texas law for at least half a century."<sup>51</sup> Based upon that theory, the court concluded that "both fractions in this deed must be given effect because there is no express future-lease clause to conflict with the granting clause."<sup>52</sup>

The court acknowledged that its ruling may not have reflected "the parties' subjective intent"<sup>53</sup> and that the "two-grant" doctrine may not "comport with what the parties probably intended. . . ."<sup>54</sup> But the court, having held that the deed was unambiguous, refused to consider the parties' subjective intent, pointing out that Concord had not sought reformation and that the issue was "interpretation of the deed as written, not reformation to reflect subjective intent."<sup>55</sup>

## B. ASSIGNMENTS OF MINERAL INTERESTS

In *Robbins v. HNG Oil Co.*<sup>56</sup> the Beaumont Court of Appeals affirmed a summary judgment construing a December 14, 1911 deed to real property from Ephriam Garonzik to James Meaders.<sup>57</sup> Abigail Meaders, plaintiff and appellant, through her attorney-in-fact, Jewell Robbins, claimed title, as an heir of James Meaders, to four tracts of land specifically described in the 1911 deed and to thirty-seven additional tracts of land not specifically described in the deed. Claiming a one-eighths interest in the oil, gas and other minerals, she sought an accounting from defendant HNG Oil Company, and others,<sup>58</sup> for unpaid royalties. Robbins's claim to the additional tracts was based upon language in the 1911 deed which stated that the property conveyed was all of the property that J. H. McFaddin, R. D. McFaddin and A. J. McFaddin inherited through their ancestor, William McFaddin. The thirty-seven additional tracts, although not described in the deed, were alleged to have been part of the William McFaddin estate and therefore conveyed by the deed.

The Beaumont court addressed four points of error raised by Robbins. The first point of error alleged that the lower court erred in construing the deed to convey only the four specifically described tracts of land, rather than all tracts which were part of the William McFaddin estate. Finding that Robbins had not raised the issue of ambiguity of the deed in the lower court, the appellate court held that the meaning of the deed

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50. *Concord Oil*, 878 S.W.2d at 195 (citing *Woods v. Sims*, 154 Tex. 59, 273 S.W.2d 617 (1954); *Richardson v. Hart*, 143 Tex. 392, 185 S.W.2d 563 (1945)).

51. *Id.*

52. *Id.*

53. *Id.* at 194.

54. *Id.* at 195.

55. *Id.* at 194.

56. 878 S.W.2d 351 (Tex. App.—Beaumont 1994, writ dismissed w.o.j.).

57. *Id.* at 353.

58. The other defendants were Elf Aquitaine, Inc., IMC Exploration Company, Pogo Producing Company and Westland Oil Development Corporation.



was a question of law for the court.<sup>59</sup> The court cited *Lewis v. East Texas Fin. Co.*<sup>60</sup> for the rule that it may not consider even the circumstances surrounding the transaction when the instrument is unambiguous and *Reynolds v. McMan Oil & Gas Co.*<sup>61</sup> for the rule that a party's intention, however discovered, cannot contradict or destroy the legal effect of the wording and language used.<sup>62</sup> Relying on the case of *Coffee v. Manly*,<sup>63</sup> the court held that the specific descriptions of the four tracts in the 1911 deed controlled over the reference to the source of the interest in the four tracts.<sup>64</sup> The court stated:

The [*Coffee*] court held that where a recitation was made to another deed or another record for the purpose of showing from what source the real property had been derived and as a help in tracing the title, then such a reference or referral will not and could not operate to enlarge the specific description given in the deed which contained the reference.<sup>65</sup>

The first point of error was, therefore, overruled.<sup>66</sup>

The court also rejected Robbin's second point of error, contending that the appellees' summary judgment evidence was insufficient as a matter of law to support the judgment granted in the lower court.<sup>67</sup> The court described Robbin's argument under this point of error as follows:

As briefed by the appellant, this point of error two deals only with the issue of which properties were conveyed. First the appellant concedes that the interpretation of real property descriptions is normally a matter exclusively for the court; nevertheless, the appellant further argues that when there is an uncertainty in the description that does not appear on the face of the deed but had its origin in extraneous fact or an ambiguity, then the identity of the land becomes a mixed question of fact and law and must be determined by a jury.<sup>68</sup>

In overruling this point of error, the Beaumont court concluded that the four tracts were not described with uncertainty and that the 1911 deed was not ambiguous.<sup>69</sup> In connection with her second point of error, Robbins also apparently complained of: (1) the failure by defendants to submit summary judgment evidence of nonownership and nonproduction of minerals on the thirty-seven tracts of land not actually the described in 1911 deed; and (2) the lack of such evidence by defendant Pogo Producing Company with respect to all tracts, including the four tracts specifically described by the deed. Given its prior ruling that the deed did not

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59. *Id.* at 354 (citing *Myers v. Gulf Coast Minerals Management Corp.*, 361 S.W.2d 193 (Tex. 1962)).

60. 136 Tex. 149, 146 S.W.2d 977 (1941).

61. 11 S.W.2d 778 (Tex. Comm'n App. 1928, holding approved).

62. *Robbins*, 878 S.W.2d at 354.

63. 166 S.W.2d 377 (Tex. Civ. App.—Eastland 1942, writ ref'd).

64. *Robbins*, 878 S.W.2d at 355.

65. *Id.* at 354-55.

66. *Id.* at 355.

67. *Id.* at 356.

68. *Id.* at 355.

69. *Robbins*, 878 S.W.2d at 355.

convey any tracts other than the four specifically described tracts, the court found it unnecessary to address the alleged lack of evidence in connection with thirty-seven of the tracts.<sup>70</sup> As to the lack of a nonownership and nonproduction affidavit by Pogo Producing Company in connection with the four described tracts, the appellate court held that Meaders had failed to prove her chain of title to three of the four described tracts of land. She failed to prove her claim of title because these tracts had not been included in the inventory of William McFaddin's estate.<sup>71</sup> As to the remaining tract, the court held that an affidavit filed by an owner of a title company, stating that he could not locate any instrument granting any interest in that tract to any defendant, and did not know of any oil and gas production on the tract, was sufficient to uphold the summary judgment in favor of Pogo Producing Company.<sup>72</sup>

The court's conclusions that the 1911 deed conveyed only four tracts of land, that Robbins established a proper chain of title only to one of those four tracts, and that there was no evidence of either production of minerals or of ownership of the remaining tract by any defendant, in fact disposed of all of the issues in the case. The El Paso court, however, engaged in a lengthy discussion of the doctrines of collateral estoppel, res judicata and stare decisis.

Robbins was also the plaintiff in two federal court cases decided by the Fifth Circuit Court of Appeals, styled *Robbins v. Amoco Prod. Co.*<sup>73</sup> and *Clark v. Amoco Prod. Co.*<sup>74</sup> The Beaumont Court of Appeals thus stated: "We determine that the doctrine of collateral estoppel properly applies and is a correct basis for one of the separate, independent grounds for the granting of the motion for summary judgment."<sup>75</sup> The court rejected Robbins' argument that a lack of mutuality of parties should have defeated defendants' motion for summary judgment on the ground of collateral estoppel.<sup>76</sup> In this regard, the court relied upon *Eagle Properties Ltd. v. Scharbauer*,<sup>77</sup> for the rule that the doctrine of collateral estoppel applies where the party against whom it is asserted was a party, or in privity with a party, in prior litigation.<sup>78</sup> Noting that Robbins was a party in both prior federal cases,<sup>79</sup> both in her individual capacity and on behalf of 200 heirs of James Meaders, the court stated: "In this State [sic] litigation [Robbins] is suing as the attorney-in-fact for Abigail, as the heir of James Meaders. Therefore, we conclude that Abigail is in

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70. *Id.* at 356.

71. *Id.* at 362.

72. *Id.* at 356-57, 363.

73. 952 F.2d 901 (5th Cir. 1992).

74. 908 F.2d 29 (5th Cir. 1990).

75. *Robbins*, 878 S.W.2d at 357.

76. *Id.*

77. 807 S.W.2d 714 (Tex. 1990).

78. *Robbins*, 878 S.W.2d at 357. The court also cited *Myrick v. Moody Nat'l Bank*, 590 S.W.2d 766, 769 (Tex. Civ. App.—Houston [14th Dist.] 1979, writ ref'd n.r.e.); *Hardy v. Fleming*, 553 S.W.2d 790, 793 (Tex. Civ. App.—El Paso 1977, writ ref'd n.r.e.); *Tarter v. Metropolitan Sav. & Loan Ass'n*.

79. *Id.* at 357-58.

privity with the two hundred heirs of the same James Meaders inasmuch as she claims directly under James Meaders. . . ."<sup>80</sup> Although the holding is probably correct, the court cited no authority for the rule that privity necessarily exists between all heirs of a common ancestor.

In addition, the court seemingly added a new factor to be considered in determining whether a claim is barred by collateral estoppel, i.e., "an identity of lawyers at crucial times."<sup>81</sup> The court stated:

It is significant and important that in the Federal [sic] court suit that Robbins as plaintiff both in the trial court and as appellant in the appeal was represented by the legal professional who has represented Robbins in the case at bar at the time the summary judgment for the defendants was granted.<sup>82</sup>

The court concluded that the federal and state cases involved identical issues of law, and that those issues were actually litigated in federal court and were essential to the judgment.<sup>83</sup>

Finally, the court also upheld the lower court's summary judgment in favor of defendants under the doctrine of stare decisis,<sup>84</sup> and what the court referred to as "the [d]octrine of [i]ssue [p]reclusion a/k/a [p]reclusion by [j]udgment."<sup>85</sup>

## II. OIL, GAS AND MINERAL LEASES

### A. LEASE COVENANTS

*Rogers v. Ricane Enterprises*<sup>86</sup> was a trespass to try title case filed by the plaintiffs under a partial assignment of an oil and gas lease to recover possession of a working interest in a 329.3 acre tract. In general, the issues were presented as attacks on plaintiff's proof of superior title out of a common source. The supreme court, in a divided opinion,<sup>87</sup> reversed the trial court and the court of appeals and held that plaintiffs had proved their title.

In 1937 an oil and gas lease from Dean to Wiggins covered 793 acres (base lease), and provided for a primary term of ten years and "as long

80. *Id.* at 358.

81. *Id.*

82. *Id.*

83. *Id.*

84. *Id.* at 361 (citing *Case-Pomeroy Oil Corp. v. Pure Oil Company*, 279 S.W.2d 886 (Tex. Civ. App.—Waco 1955, writ ref'd)).

85. *Id.* (citing *Van Dyke v. Boswell, O'Toole, Davis & Pickering*, 697 S.W.2d 381 (Tex. 1985); and RESTATEMENT (SECOND) OF JUDGMENTS § 27 (1980)). The court was presumably referring to the doctrine of res judicata. The court stated: "We hold in this case that it is correct to give effect to the holdings, judgments, and opinions of the Fifth Circuit Court [sic]." *Robbins*, 878 S.W.2d at 362.

86. 884 S.W.2d 763 (Tex. 1994). This is the fourth appellate opinion written in this dispute. See 772 S.W.2d 76 (Tex. 1989), 775 S.W.2d 391 (Tex. App.—Amarillo 1989, writ granted), and 852 S.W.2d 751 (Tex. App.—Amarillo 1993, writ granted) for the previous opinions. See also James V. Hammett, Jr. and Deborah E. Taylor, *Oil, Gas and Mineral Law, Annual Survey of Texas Law*, 47 SMU L. REV. 1439, 1453 (1994).

87. *Id.* at 770. Inexplicably, the majority and dissent broke out into the all-too-familiar teams common to personal injury actions.

thereafter as oil and gas . . . is produced. . . .”<sup>88</sup> The lease provided that after expiration of the primary term, and upon cessation of production, the lessee would have sixty days within which to commence operations. The lease was assignable in whole or in part and provided that if the leased premises “shall hereafter be owned in the severalty or in separate tracts, the premises, nevertheless shall be developed . . . as one lease. . . .”<sup>89</sup>

Production was promptly obtained on the lease and continued through all times material to the case, thereby keeping the base lease alive. On June 1, 1949, Superior Oil Company (Superior), which had acquired the base lease by assignment, assigned a leasehold interest in 329.3 acres out of the 7893 acres upon which there was no production to Western and others. The assignment required Western to drill a well within thirty days, failing which the assignment would “cease and terminate and . . . revert to and revest in Superior. . . .”<sup>90</sup> Western also agreed to assume all “express and implied base lease obligations. . .” and recognized that “there now are a number of . . . offset wells which Western shall protect against by the drilling of properly located wells on the . . . land.”<sup>91</sup>

The assignment also provided:

5.

In the event that the production of oil, gas . . . is developed . . . and Western desires to abandon or cease operating the same, Western shall notify Superior . . . and Superior may, at its election, require Western to transfer and assign to Superior . . . all of Western’s right . . . to said lease. . . .

6.

Upon termination of the rights of Western hereunder and/or with respect to the . . . lease . . . or otherwise, Western shall deliver to Superior upon demand, a good and sufficient quit-claim deed and release. Any delay . . . of Western to deliver any such quit-claim and release shall in no way prevent such rights from terminating, and reverting to and revesting in Superior as herein expressly provided and contemplated.<sup>92</sup>

Western promptly drilled a producing well. During the life of the well, in August 1960, E. P. Campbell, the president and a stockholder of Western, *in his individual capacity only*, sold, assigned, and transferred to Dakota Company, Inc. (Dakota)<sup>93</sup>

all of the right title and interest . . . as conveyed to [him] by Assignments of record [including conveyance of] all of [his] right, title and interest . . . in [the base lease] . . . insofar as said lease covers the . . . 329.3 acres . . . subject to the exceptions, reservations and provisions

88. *Id.* at 764.

89. *Id.*

90. *Rogers v. Ricane*, 772 S.W.2d 76, 78 (Tex. 1989).

91. *Id.* at 78.

92. *Rogers*, 884 S.W.2d at 765-66.

93. *Id.* at 765, 769. Campbell was also an officer and director of Dakota. *See Rogers*, 852 S.W.2d at 755.

. . . stated, but all without warranty of any kind, either expressed or implied.<sup>94</sup>

Though the assignment refers to previous conveyances to Campbell, neither the instruments nor evidence sufficient as a substitute were introduced. Through a series of conveyances thereafter, Ricane Enterprises, et al. succeeded to the rights of Dakota and in October 1979, drilled a successful well.

The early well, which had been drilled on the 329.3 acres, ceased production in July 1961, and no drilling activity or production had occurred after that date until the Ricane well in 1979. Campbell died in 1961 and in 1965 Western's charter was forfeited by the State of Texas for non-payment of franchise taxes. A former Western director and shareholder testified that he wound up Western's affairs and that it was insolvent, but he did not testify as to the title to the working interest.

The plaintiffs, who were stockholders and other successors to the assets of Western, filed suit in 1984 against Ricane in trespass to try title for possession of the 329.3 acres. Following the successful appeal by the plaintiffs of a summary judgment for defendants, the case was tried to a jury which answered eighteen different issues. Among them were findings that Western had "abandoned or ceased operating" the premises and that Western had "abandoned the purposes" of the assignment.<sup>95</sup> The trial court entered a take-nothing judgment against the plaintiffs and the court of appeals affirmed on the ground that the lease had terminated in light of the jury's finding of abandonment of purpose.<sup>96</sup>

Ricane first attacked the plaintiff's title by arguing that the assignment terminated by its own terms under its paragraphs 5 and 7, because of Western's failure to transfer the premises back to Superior.<sup>97</sup> The court, however, held that paragraph 7 was "triggered [only] upon failure of some other provision leading to termination of Western's rights. . . ." and that the only condition which could lead to automatic termination of the assignment was a failure to drill the initial well within 30 days.<sup>98</sup>

Ricane also argued that under the doctrine of *Texas Co. v. Davis*,<sup>99</sup> the assignment had automatically terminated, either because of abandonment or because the purpose of the assignment had ceased with cessation of production. The court reaffirmed the *Davis* doctrine, but distinguished it because "the assignment in this case does not, by its express terms, specify a purpose for the assignment and does not contain any language

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94. *Id.* at 769.

95. *Rogers*, 852 S.W.2d at 759.

96. *Rogers*, 884 S.W.2d at 765.

97. *Id.* at 766. Apparently, Superior sent two letters to Western in 1966 demanding a reassignment because of the cessation of production. Superior, however, did not sue to enforce its rights and was never made a party to this litigation. *Id.* at 770.

98. *Id.* at 766.

99. 113 Tex. 321, 254 S.W. 304 (1923). The court also cites *W.T. Waggoner Estate v. Sigler Oil Co.*, 118 Tex. 509, 19 S.W.2d 27, 29 (1929) in which the court distinguished the theories of abandonment of title, which Texas does not recognize, and the cessation of use of an oil and gas lease doctrine established by *Davis*. *Rogers*, 884 S.W.2d at 767.

limiting the duration of the assignment to 'as long as' oil and gas is produced."<sup>100</sup> Finding that *Davis* did not control, the Court held that the finding of abandonment of purpose was immaterial.

The court further found that provisions for termination in the base lease did not control the rights of Rogers and Ricane and that the assignment, which did not clearly and unequivocally create a conditional estate, did not contain an implied determinable fee.<sup>101</sup> The court also noted that even if a drilling purpose were implied, the appropriate remedy would be an action for breach of that implied covenant, and not automatic termination.<sup>102</sup>

Ricane also argued that Rogers had failed to prove a superior title as required in a trespass to try title case.<sup>103</sup> Ricane's first point was that Rogers had failed to prove a regular chain of conveyances into plaintiffs, because in some way (and the court is not clear on this), Western's title disappeared in the wake of its insolvency and the forfeiture of its charter.<sup>104</sup> The court held, however, that upon forfeiture of the charter, the shareholders of the company became trustees of its property for the benefit of its creditors<sup>105</sup> and that no showing of a transfer of title out of the shareholders had been made.<sup>106</sup>

Ricane's second point was that Rogers had failed to prove a superior title, because Ricane's assignment from Western, coming earlier in time, was superior. The court, however, held that the assignment from Campbell to Dakota was nothing more than a quitclaim, conveying title only if Campbell held title, and that Ricane had failed to prove that Campbell, individually, held any title to the 329.3 acres.<sup>107</sup>

Ricane also argued a "reverse alter ego doctrine" theory, to the effect that in executing the assignment to Dakota, Campbell was de facto the company, Western. The court refused the argument and held that

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100. *Rogers*, 884 S.W.2d at 767.

101. *Id.*

102. *Id.*

103. While the parties agreed that the method of proving title in this case would be by superior title from a common source, the court noted that other available methods of proving title in a trespass case were by proving a regular chain of conveyances from the sovereign, proving title by limitations, or by proving prior possession, not abandoned. There was no need for Rogers to prove common source due to Ricane's agreement that both parties derived whatever title they held from Western, the common source. *Id.* at 768.

104. *Id.* at 769.

105. *Id.* at 768.

106. *Id.* at 769. If unpaid creditors of Western still exist, it would seem that the now successful stockholders of the defunct company would remain trustees of its assets, subject to applicable limitations statutes, if any.

107. *Id.* at 765. The court notes that if Campbell's assignment had contained a warranty, his heirs, who were also plaintiffs in the Rogers group, might have been estopped to assert trespass to try title. *Id.* at 769 n.5 (citing *Clark v. Gauntt*, 138 Tex. 558, 161 S.W.2d 270, 271-72 (1942)). Other than its possible effect on Campbell's heirs, it is difficult to see how a warranty could have affected the result in this case. Once the issue of termination was decided, Ricane could argue no more than that Western breached its covenants in the Superior assignment, a position which only Superior could assert in the absence of other pleading such as third party beneficiary entitlement. See *San Antonio Loan & Trust Co. v. Rabb*, 155 S.W.2d 981 (Tex. Civ. App.—San Antonio 1941, writ ref'd. w.o.m.)

“[b]ecause Campbell executed the instrument in personal capacity, and the instrument itself does not reflect that Campbell purports to act on behalf of Western, the reverse alter ego theory does not apply.”<sup>108</sup> The court further held that there was no evidence that Western ratified Campbell’s assignment.<sup>109</sup>

Finally, Ricane argued that division orders issued by Superior recognized its title, thereby in some way creating title in Ricane. The court held, however, that “[w]hile a division order can create a contractual relationship, it does not transfer title” and that “division orders do not replace or invalidate the original assignment.”<sup>110</sup>

Rogers had also sued for conversion of its runs for the period of time since the Ricane well was drilled in 1979. The court of appeals had not considered those points, so the supreme court remanded the case to the appeals court.

The dissent argued that the *Davis* case should control the result. Taking issue with the majority’s position that in order for *Davis* to control, there must have been an express statement of purpose in the Superior assignment, the dissent argued that the absence of express language of purpose did not mean that the contract had no purpose.<sup>111</sup> Further arguing that the purpose was for exploration, development and production of oil and gas, the dissent concluded that “a complete failure to pursue that purpose—’not a partial use, nor a negligent use, nor an imperfect use, but cessation of use’<sup>112</sup> is an abandonment of the purpose, which terminates the estate.”<sup>113</sup>

*J.M. Huber Corp. v. Santa Fe Energy Resources, Inc.*<sup>114</sup> involved the construction of four oil and gas leases between J.M. Huber or Mobil Producing Texas and New Mexico, Inc., as lessees, and Santa Fe Energy Resources, Inc., as lessor. The clauses at issue concerned the payment of taxes and came in two forms. The earlier lease forms read:

It is expressly agreed that during the life of this lease Lessee shall pay all taxes of every kind lawfully levied or assessed upon or against all or any part of the minerals in or under said land and/or the production thereof, including gross production and severance taxes and transportation taxes, and all increases in taxes on the land resulting from the prospecting for and discovery and/or production of minerals therefrom.<sup>115</sup>

The more recent lease forms read:

108. *Id.* at 769.

109. *Id.*

110. *Id.* at 770.

111. *Id.*

112. *Id.* at 770-71 (citing *Waggoner Estate*, 19 S.W.2d at 29).

113. *Id.* But see the majority’s argument, citing *Waggoner Estate*, 19 S.W.2d at 32, that courts should not find that a lease has been forfeited or terminated upon breach of an implied obligation. *Id.* at 767.

114. 871 S.W.2d 842 (Tex. App.—Houston [14th Dist.] 1994, writ denied).

115. *Id.* at 843, n.1.

During the life of this lease, Lessee shall pay all taxes of every kind lawfully levied or assessed upon or against all or any part of the oil and gas in or under said Leased Premises and/or the production thereof, including gross production, severance and transportation taxes, and all increases in taxes on the Leased Premises resulting from the prospecting for, discovery or production of oil and gas therefrom.<sup>116</sup>

The disputed tax was the Crude Oil Windfall Profit Tax Act of 1980.<sup>117</sup> The lessees had withheld from royalty payments to Santa Fe the amount of the windfall profit tax due and had remitted the tax to the United States government. Santa Fe maintained that the leases shifted the burden of paying the windfall profit tax to the lessees and filed its action for a declaratory judgment that payment of all windfall profit taxes were, under the express lease provisions, the burden of the lessees. The lessees contended that the lease provisions did not apply to the windfall profit tax and that the suit was expressly barred by federal law and by explicit lease provisions. The trial court granted a summary judgment in favor of Santa Fe, and the lessees appealed.

The appellate court first discussed *Santa Fe Energy Co. v. Baxter*,<sup>118</sup> which it cited for the rules that the determination of the character of the windfall profit tax was a matter of state law, and that the tax was similar to an excise or severance tax which may be shifted to an oil and gas lessee under an appropriate tax shifting provision in a lease.<sup>119</sup> The court was unpersuaded by the lessees' argument that *Baxter* was wrongly decided and should be overruled on the basis that the court is "bound by the decisions of lower federal courts regarding construction of this federal taxing act."<sup>120</sup>

Relying upon *Carlisle v. Philip Morris, Inc.*,<sup>121</sup> *Barstow v. State*,<sup>122</sup> and *Penrod Drilling Corp. v. Williams*,<sup>123</sup> the appellate court held that only the opinions of the United States Supreme Court are controlling in a state court on federal matters; the opinions of lower federal courts are persuasive, but not binding.<sup>124</sup> The court expressly rejected the argument that *Holmes v. Olson*<sup>125</sup> requires Texas courts to follow federal court decisions, stating:

In construing its own opinion in *Olson* and the supreme court's per curiam opinion refusing application for writ of error, the Austin court of appeals noted that they did not intend to hold that state

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116. *Id.* at 843.

117. 26 U.S.C. § 4986(a) (repealed 1988).

118. 783 S.W.2d 643 (Tex. App.—Houston [14th Dist.] 1989, writ denied).

119. *J.M. Huber Corp.*, 871 S.W.2d at 845-46.

120. *Id.* at 846.

121. 805 S.W.2d 498, 505 (Tex. App.—Austin 1991, writ denied).

122. 742 S.W.2d 495, 501 n.2 (Tex.App.—Austin 1987, writ denied).

123. 865 S.W.2d 294 (Tex. 1993).

124. *J.M. Huber Corp.*, 871 S.W.2d at 846.

125. 587 S.W.2d 678 (Tex. 1979).



courts are bound by lower federal court opinions, but that such decisions are entitled to due weight and consideration.<sup>126</sup>

The Fourteenth Court of Appeals then refused to hold that two decisions of the Ninth Circuit Court of Appeals required the overruling of its decision in *Baxter*.<sup>127</sup> It was not persuaded by *Tenneco West, Inc. v. Marathon Oil Co.*<sup>128</sup> even though the Ninth Circuit, interpreting a similar tax shifting provision, held that the burden of payment of the windfall profit tax was not shifted to the lessee.<sup>129</sup> Finding that the Ninth Circuit decided the case on the basis of California rather than federal law, the Fourteenth Court of Appeals stated: "The [Ninth Circuit] relied on a [California] state law case<sup>130</sup> containing an almost identical clause which held that such a clause did not encompass the windfall profits tax."<sup>131</sup> Consequently, it found that the Ninth Circuit's later characterization of the tax as an incremental value tax rather than an excise tax was purely dictum. The court dismissed the other Ninth Circuit case, *Exxon Corp. v. City of Long Beach*,<sup>132</sup> as relying entirely on *Tenneco West*.<sup>133</sup> Finally, the appellate court also held that the decisions of Texas courts in *Stanolind Oil & Gas Co. v. Terrell*,<sup>134</sup> *Cities Service Oil Co. v. McCrory*,<sup>135</sup> *Fain-McGaha Oil Corp. v. Murko Oil & Royalty Co.*,<sup>136</sup> and *Felber v. Sklar Oil Co.*,<sup>137</sup> to be inapplicable as involving "free of all cost" provisions rather than tax shifting provisions.<sup>138</sup>

The Fourteenth Court of Appeals also rejected the arguments of Mobil Producing Texas and New Mexico, Inc. that Santa Fe's action was barred by federal law and by explicit provisions of the leases.<sup>139</sup> It held that Mobil was not immune from the action under 26 U.S.C. section 4995(a)(1)(B) because the lease expressly shifted the liability for payment of the windfall profit tax to Mobil.<sup>140</sup> The court also held that payment of the windfall profit tax did not constitute payment to Santa Fe under 26 U.S.C. section 4495(a)(4), providing that the producer of any crude oil is treated as having paid any amount withheld under the subsection, be-

126. *Id.* at 846 (citing *Carlisle v. Philip Morris, Inc.*, 805 S.W.2d 498, 505 (Tex. App.—Austin 1991, writ denied)).

127. *Id.* at 846.

128. 756 F.2d 769, 773 (9th Cir. 1985).

129. *J.M. Huber Corp.*, 871 S.W.2d at 846.

130. See *Crocker Nat'l Bank v. McFarland Energy, Inc.*, 140 Cal. App. 3d 6, 189 Cal. Rptr. 302 (2d Dist. 1983).

131. *J.M. Huber Corp.*, 871 S.W.2d at 846.

132. 812 F.2d 1256, 1259 (9th Cir. 1987).

133. *J.M. Huber Corp.*, 871 S.W.2d at 846.

134. 183 S.W.2d 743 (Tex. Civ. App.—Galveston 1944, writ ref'd).

135. 191 S.W.2d 791 (Tex. Civ. App.—Fort Worth 1945, no writ).

136. 128 Tex. 646, 101 S.W.2d 547 (1937).

137. 235 S.W.2d 481 (Tex. Civ. App.—Texarkana 1950, writ ref'd).

138. *J.M. Huber Corp.*, 871 S.W.2d at 847.

139. *Id.* at 847-48.

140. *Id.* at 848. Mobil relied upon *Robinson v. A & M Electric, Inc.*, 713 F.2d 608 (10th Cir. 1983). *Id.*

cause the parties had agreed that it was Mobil, and not Santa Fe, who owed the tax.<sup>141</sup>

Finally, and with little explanation, the court held that the leases themselves did not bar Santa Fe's suit by providing that they are subject to all valid federal law, rules and regulations, because the tax shifting clauses do not require a violation of the laws; and that the clauses do not defeat the congressional purpose of the tax by allowing Santa Fe to receive the windfall that Congress sought to tax since the parties agreed to the clauses.<sup>142</sup>

*Kiewit Texas Mining Co. v. English*<sup>143</sup> was a dispute as to the proper damages to be awarded for the repudiation and anticipatory breach of a coal and lignite lease by the lessors, Kiewit Texas Mining Company and Phillips Coal Company.<sup>144</sup> The lease had a primary term of twenty-five years, but was repudiated in 1989, the twelfth year of the primary term. As damages, the trial court awarded the plaintiffs the present value of all annual advance royalties which would have been due had Kiewit honored the lease for the thirteen years remaining in the primary term, and the present value of a twelfth and a twenty-fifth year bonus provided for by the lease. The Waco Court of Appeals reversed the judgment of lower court, finding that plaintiffs were entitled only to the value of the advance royalties for the years 1989 and 1990, and to the twelfth year bonus due in 1989.<sup>145</sup>

The lease was signed in June 1977. However, no coal or lignite was ever produced or mined on the leased acreage. In addition to a "production royalty," the lease provided for an annual "advance royalty," which was not related to production, and the bonus payments. The clauses on bonus payments stated, in part:

In the event that mining operations have not been commenced by Lessee hereunder prior to the fifth anniversary date hereof (June 28, 1982), Lessee shall pay or tender to Lessor, within thirty days after said fifth anniversary date, an additional bonus consideration for this Lease equal to [\$100] per acre. . . .

Upon the twenty-fifth (25th) anniversary date of this Lease and if this Lease is to be extended by other provisions herein, then this Lease shall then terminate unless, on or prior to such date, Lessee shall pay Lessor a sum of money equal to [\$500] per acre (representing a \$400.00 per acre additional bonus, and the \$100.00 per acre advance royalty for the succeeding year under paragraph 4 of this Lease). . . . If such payment is made then this Lease shall continue in force and effect as provided by other provisions of this Lease.<sup>146</sup>

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141. *Id.*

142. *Id.*

143. 865 S.W.2d 240 (Tex. App.—Waco 1993, writ denied).

144. *Id.* at 242. On appeal, the defendants conceded a breach and repudiation of the lease and so limited the appeal to questions of damages. *Id.*

145. *Kiewit Mining*, 865 S.W.2d at 247.

146. *Id.* at 242-43.

The lease provided for a right of surrender, as follows:

Lessee may at any time from this date execute and deliver to Lessor or place of record a legally sufficient release covering all of the Premises and thereupon terminate this Lease as to all of the Premises. Lessee shall thereupon be released from all further obligations and duties as to the Premises so released, including any obligation to make advance royalty payments described in paragraph 4, except obligations accrued as of the date of surrender. . . .<sup>147</sup>

However, the right to surrender the lease was restricted as set forth below:

Attached to this Lease, as Exhibit "D", is a list of Coal Leases, excluding this Lease, all naming Lessee as the mining lessee thereunder, all covering tracts of adjacent lands. Notwithstanding the provisions of paragraphs 11 and 14 hereof, Lessee may not release any of the Premises covered hereby or assign this Lease unless and until it likewise executes, delivers, and records like releases or assignments covering all lands conveyed by the leases tabulated in Exhibit "D". This provision shall have no application to releases subsequent to the completion of mining and reclamation.<sup>148</sup>

Finally, the lease addressed termination by either party:

Termination of this Lease under any paragraph or on account of any circumstances or event or on account of the fault, option, or action of any person, entity, or party shall be subject to this subparagraph 11(f) and its subparts.

...  
 (iii) Termination of this Lease shall in no way diminish or terminate the obligations of Lessee to make any payments to Lessor as may then be due or accrued or as may become due before such termination becomes effective and such termination shall not entitle Lessee to demand return of any amounts paid to Lessor prior to such termination, including, but not limited to, unearned advance payments.<sup>149</sup>

On appeal, Kiewit argued that the lease terminated in 1989 when the plaintiffs' accepted the repudiation of the lease,<sup>150</sup> and that under the express terms of the lease, no obligation for future payments ever accrued. In addition, Kiewit contended that there was a failure of conditions precedent to their obligation to make future payments under the lease. The plaintiffs contended that the trial court properly awarded them the present value of all payments that could have have been due under the terms of the lease.

The Waco Court of Appeals first held that the lease language was clear and unambiguous, and did not limit or specify the type of damages that a

147. *Id.* at 243.

148. *Id.*

149. *Id.* at 244.

150. The case was tried to the trial court, who concluded that Kiewit repudiated the lease on June 28, 1989 and that the plaintiffs accepted that repudiation. Neither conclusion was apparently challenged on appeal. *Id.* at 244.

non-breaching party can recover.<sup>151</sup> The court therefore rejected the argument that the lease, by its own terms, prohibited the recovery of payments after its repudiation or termination.<sup>152</sup> The court also rejected the argument that no royalties or bonuses were due after the repudiation and termination of the lease in 1989, stating that the breach by Kiewit did not modify or cancel the lease obligations.<sup>153</sup> The court then found that plaintiffs' right to damages after the breach depended upon whether the conditions on which the obligation were based occurred, or if not, were excused.<sup>154</sup>

The court defined a condition precedent as "those acts or events, which occur subsequently to the making of a contract, that must occur before there is a right to immediate performance and before there is a breach of contractual duty."<sup>155</sup> The appellate court held that payment obligations under the lease were dependent upon at least two conditions; the obligation to pay advance royalties was conditioned upon the lease being in force on its anniversary date and the obligation to pay the twenty-fifth year bonus was conditioned upon extension of the lease beyond the primary term.<sup>156</sup> The court held that after the breach of the lease by Kiewit, neither of the necessary events occurred.<sup>157</sup>

The court noted that the non-occurrence of a condition is excused when a party's repudiation contributes materially to its non-occurrence, but is not excused where the condition would not have occurred under any circumstances.<sup>158</sup> Therefore, the court held that the plaintiffs could not recover annual advance royalties or the twenty-fifth year bonus unless they pleaded and proved that the necessary conditions would have occurred but for the breach by Kiewit.<sup>159</sup> The court then examined the record for plaintiffs' evidence of the value of the expected performance.

As to the obligation to pay the twenty-fifth year bonus the court found that the evidence conclusively established that the lease would not have been extended beyond the primary term.<sup>160</sup> Therefore, there would have been no obligation to make the payment even if no breach occurred, and so the twenty-fifth year bonus was not lost as a result of the breach.

As to payments of advance royalties, the court held that the plaintiffs had proved that the failure of the condition precedent to the payment of advance royalties was excused for the year 1990, because Kiewit had ma-

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151. *Kiewit Mining*, 865 S.W.2d at 244.

152. *Id.*

153. *Id.* at 245 (citing *Newman v. San Antonio Traction Co.*, 155 S.W. 688, 690 (Tex. Civ. App.—San Antonio 1913, no writ)).

154. *Id.*

155. *Id.* (quoting *Hohenberg Bros. Co. v. George E. Gibbons & Co.*, 537 S.W.2d 1, 3 (Tex. 1976)).

156. *Id.*

157. *Id.*

158. *Id.* (citing RESTATEMENT (SECOND) OF CONTRACTS § 255 (1981)).

159. *Id.* (citing *City of Fort Worth v. Rosedale Park Apartments*, 276 S.W.2d 395, 397 (Tex. Civ. App.—Fort Worth 1955, writ ref'd); *Howell v. Kelly*, 534 S.W.2d 737, 740 (Tex. Civ. App.—Houston [1st Dist.] 1976, no writ)).

160. *Id.* at 245-46.

terially contributed to the non-occurrence by breaching the lease.<sup>161</sup> The court then held that there was no evidence that the lease would have been in effect after 1990 even had there been no breach by Kiewit, however, and held that the non-occurrence of the condition precedent to payment of advance royalty was not excused for any year after 1990.<sup>162</sup>

The court apparently relied on the fact that in 1991 Kiewit released all of the Exhibit "D" leases, and then released the disputed lease, thereby complying with the voluntary surrender provision of the lease.<sup>163</sup> The court noted that the law will not allow Kiewit to rely upon advantageous lease provisions after breaching that lease,<sup>164</sup> and stated that its holding should not be interpreted as implicitly giving effect to the surrender provision of the lease.<sup>165</sup> The court reasoned that it was the surrender of the Exhibit "D" leases which conclusively established that the lease at issue would not have remained in effect after 1990, and not the surrender of the breached lease itself.<sup>166</sup>

It should be noted that the appellate court devoted considerable effort to the question of the proper measure of damages for breach of the lease, and held that damages for the anticipatory repudiation of a lease are the same as damages for any breach of any contract, i.e., those damages necessary to compensate the innocent party for the damages actually sustained.<sup>167</sup> The amount necessary to compensate the plaintiffs was held, however, to be the expected value of performance of the lease, as opposed to the face value of the contract.<sup>168</sup> The court rejected the plaintiffs' argument that *Pollack v. Pollack*<sup>169</sup> entitled them to the face value of the contract.<sup>170</sup> The *Pollack* court stated: "[The plaintiff] is entitled in one suit to receive in damages the present value of all that he would have received if the contract had been performed."<sup>171</sup> The court declined to adopt what it termed a literal interpretation of the quoted language from

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161. *Id.* at 246.

162. *Id.*

163. *Id.*

164. *Id.* at 246 (citing *Baker Marine Corp. v. Weatherby Eng'g Co.*, 710 S.W.2d 690, 696 (Tex. App.—Corpus Christi 1986, no writ).

165. *Id.* at 247.

166. *Id.* However, this reasoning is not persuasive. The lease allowed Kiewit to surrender the lease voluntarily, and had it done so, Kiewit could have avoided any subsequent payment obligations during the remainder of the primary term of the lease. It did not surrender the lease, however, but instead chose to breach its payment obligation to plaintiffs. To relieve Kiewit of liability for advance royalty payments during the primary term of the lease, upon proof that it would have surrendered the lease anyway, is to allow Kiewit to take advantage of the instrument it breached and is a wrong result, without regard to the specific nature of the proof.

167. *Id.* at 245 (citing *Walter H.E. Jaeger*, 11 *WILLISTON ON CONTRACTS* § 1397 (Baker Voorhis, 3d ed. 1968)).

168. *Id.* (citing *P. G. Lake, Inc. v. Sheffield*, 438 S.W.2d 952, 956 (Tex. Civ. App.—Tyler 1969, writ ref'd n.r.e.); *RESTATEMENT (SECOND) OF CONTRACTS* § 344(a) (1981)).

169. 39 S.W.2d 853 (Tex Comm'n App. 1931, holding approved).

170. *Kiewit Texas*, 865 S.W.2d at 246.

171. *Id.* at 245 (quoting *Pollack*, 39 S.W.2d at 855).

*Pollack*, concluding that the plaintiff in that case was allowed to collect, in fact, only the anticipated performance of the contract.<sup>172</sup>

## B. SURFACE/MINERAL RELATIONSHIP

In *Haupt, Inc. v. Tarrant County Water Control and Improvement Dist. Number One*<sup>173</sup> the subject of dispute was whether the district's flooding of an eighty-acre tract to create a lake was an inverse condemnation<sup>174</sup> of the minerals under that tract. In an opinion remanding the case to the Waco court,<sup>175</sup> the Texas Supreme Court had established the "law of the case" to be that the "accommodation" or "alternative means" doctrine<sup>176</sup> must be considered "in determining whether inverse condemnation has occurred when a governmental entity that owns the surface restricts the mineral owner's surface use."<sup>177</sup> The supreme court having also held that there was *legally* sufficient evidence to support the invocation of the accommodation doctrine, the issue before the court of appeals was whether there was *factually* sufficient evidence.<sup>178</sup> The court held that while there was sufficient evidence to support a trial court finding that there were alternative means of accessing the minerals, the evidence was insufficient to support a finding that those means were reasonable alternatives.

The "accommodation" or "alternative means" doctrine was established by the Texas Supreme Court in *Getty Oil v. Jones*:<sup>179</sup>

[W]here there is an existing use by the surface owner which would otherwise be precluded or impaired, and where under the established practices in the industry there are alternatives available to the [mineral owner] whereby the minerals can be recovered, the rules of reasonable usage of the surface may require the adoption of an alternative by the [mineral owner].<sup>180</sup>

The doctrine recognizes, however, that if there is only one means of surface use by which the minerals may be produced, the mineral estate, being the dominant estate, has the right to produce the minerals regardless of damage to the surface.<sup>181</sup>

The burden of proof was on the surface owner "to show that the particular manner of surface use being . . . [proposed by the mineral owner] is

172. *Kiewit Texas*, 865 S.W.2d at 245-46.

173. 870 S.W.2d 350 (Tex. App.—Waco 1994, no writ).

174. "Inverse condemnation occurs whenever property is 'taken' or 'damaged' for public use without adequate compensation." *Id.* at 351.

175. *Tarrant County Water Control and Improvement Dist. Number One v. Haupt, Inc.*, 854 S.W.2d 909 (Tex. 1993).

176. *Haupt, Inc.*, 870 S.W.2d at 353.

177. *Id.* at 352. Until the Texas Supreme Court's opinion, the accommodation doctrine had never been extended to a governmental surface owner in an inverse condemnation proceeding. *Id.* at 353. And the court notes that the subject was not raised by either party until the case was in the supreme court. *Id.*

178. *Id.* The Texas Supreme Court also held that the Water District could "only use the surface estate as a reservoir by flooding the surface." *Haupt, Inc.* 854 S.W.2d at 912.

179. 470 S.W.2d 618 (Tex. 1971).

180. *Haupt, Inc.*, 870 S.W.2d at 353 (citing *Getty Oil*, 470 S.W.2d at 622).

181. *Id.*

not reasonably necessary to the mineral owner under all circumstances. . . .” which may be done “by proving that the mineral owner has available other reasonable means of production . . . that will not interfere with the surface owner’s existing use.”<sup>182</sup>

After examining the water district’s proof, the court held that the evidence was factually sufficient to support the trial court’s finding that the mineral owners had alternative means of accessing the minerals,<sup>183</sup> such as directional drilling and platform drilling. But the court failed to find sufficient evidence that those alternatives were “reasonable”:

Assessing the reasonableness of a particular means of production, especially in the context of an inverse condemnation proceeding, must include its impact on the value of the mineral estate. . . . If, as here, a mineral owner has available several means of accessing the minerals, one of which will maximize the value of the mineral estate and other alternatives that, if used, will either totally destroy or reduce its value by three-fourths, one cannot logically or rationally argue that the alternative methods provide *reasonable* access to the minerals.<sup>184</sup>

Finding that the record “clearly shows” that the only method of drilling which would preserve the value of the mineral estate was by drilling a vertical well on dry land, the court remanded the case for new trial.<sup>185</sup>

### C. ROYALTY INTERESTS

*Atkinson Gas Co. v. Albrecht*<sup>186</sup> was an appeal by a lessee-operator (Atkinson) from a trial court judgment for the mineral-royalty owners (Albrecht) declaring that Atkinson’s lease had terminated due to cessation of production and awarding damages in the amount of a bonus lost by Albrecht when Atkinson refused to release his lease.<sup>187</sup> The case had been tried to the court and judgment entered for Albrecht, apparently without findings of fact or conclusions of law. The court of appeals affirmed.

The lease was executed in 1985, provided for a one-year primary term, and contained a sixty-day cessation of production clause. Atkinson drilled a gas well which was produced in accordance with the lease terms until December 9, 1991 when Albrecht and Atkinson’s well gauger shut in the well because of Atkinson’s failure to make timely payments, respectively, of royalty and wages. Albrecht notified Atkinson that “[t]he

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182. *Id.* An additional burden of the surface owner, which was met as a matter of law (See *Getty Oil*, *supra* note 180, at 623) was to show that “any alternative uses of the surface, other than the existing use, are impracticable and unreasonable under all the circumstances.” *Id.*

183. *Haupt, Inc.*, 870 S.W. 2d at 355.

184. *Id.* at 354.

185. *Id.* at 355.

186. 878 S.W.2d 236 (Tex. App.—Corpus Christi 1994, writ denied).

187. The only question on appeal involving the damage award was one of evidence and will not be discussed.

well was shut in today. No pay-No Gas!’ ”<sup>188</sup> Atkinson, however, disregarded the note, because the pipeline purchaser, through error, continued to report the gas as flowing at a reduced rate and continued to pay rents, including royalties, to Atkinson.<sup>189</sup>

On January 22, 1992 the Railroad Commission sealed the well due to Atkinson’s failure to file production reports, making production physically impossible. On March 18, 1992 Albrecht requested that Atkinson release the lease under the sixty-day cessation of production clause. Two days later, on March 20, 1992 the Commission order was lifted and the well commenced flowing. In April 1992 Atkinson paid and Albrecht accepted royalty payments for 1991 and 1992, which erroneously included payments for those days when the well was shut in.

Atkinson argued that by shutting in the well, Albrecht repudiated the lease, thereby relieving him of any obligation to conduct operations on the land in order to maintain the lease.<sup>190</sup> The court, however, held that there had not been a “clear, unequivocal challenge to the lessee’s title to, and interest in the lease . . .” and that Albrecht’s actions did not amount to a “lockout” which prevented Atkinson physically from entering the lease to resume production.<sup>191</sup> Finding that Atkinson was “generally free to turn the well back on,” the court held that Albrecht’s actions “failed to rise to the level of preventing Atkinson from producing or repudiating the lease.”<sup>192</sup>

Atkinson also argued that Albrecht’s actions in shutting in the well and in accepting erroneous royalty payments for the shut-in period estopped him from asserting that the lease had terminated. Recognizing that the doctrine of “quasi-estoppel” operates to prevent one from accepting the benefits of a transaction only to thereafter take an inconsistent position to avoid corresponding obligations, the court nevertheless held that “[a]lthough it may have been improper for Albrecht to inconvenience Atkinson . . .” by shutting in the well, “it was not inconsistent with Albrecht’s subsequent claim that cessation of production for the requisite period terminated the lease.”<sup>193</sup> The court concluded that Albrecht’s

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188. *Atkinson Gas*, 878 S.W.2d at 238.

189. It is common for a gas purchaser to make all payments to an operator such as Atkinson, who is then obligated to make royalty payments to the mineral owners.

190. Atkinson relied upon *Kothmann v. Boley*, 158 Tex. 56, 308 S.W.2d 1, 4 (1957), and other cases.

191. *Atkinson Gas*, 878 S.W.2d at 239. *But see* *Morriss v. First Nat. Bank of Mission*, 249 S.W.2d 269, 279 (Tex. App.—San Antonio 1952, writ ref’d n.r.e.), (holding that the non-payment of royalty does not terminate a lease, in the absence of a specific clause to that effect). While Albrecht’s actions in shutting in the gas for non-payment of royalties were arguably a breach of the lease, or at least were an interference with the lessee’s operations, the court in *Atkinson* does not characterize those actions other than to state that there was neither a repudiation nor a lockout. *Atkinson Gas*, 878 S.W.2d at 239.

192. *Id.*

193. *Id.* at 240. There is nothing in the court’s opinion as to whether any credit could or should have been given for the length of shut-in time attributable to Albrecht’s actions. Without question, some period of the shut-in time prior to the Commission’s sealing of the well was necessarily used in arriving at lack of production for more than sixty days.



conduct did not amount to a "ratification, election, acquiescence, or acceptance of benefits, as have traditionally been considered the type of conduct which may form the basis of a claim of quasi estoppel."<sup>194</sup>

The court further held that Albrecht's acceptance of the erroneously paid royalty payments for the shut-in period would not estop him from asserting that the lease had terminated.<sup>195</sup> The court reasoned that "the position or conduct which is the basis for the estoppel . . . [must] have been taken before the assertion of the position sought to be estopped."<sup>196</sup> Albrecht having asserted that the lease had terminated, which was the conduct sought to be estopped, prior to the acceptance of the royalty payments, precluded Atkinson's assertion of estoppel.<sup>197</sup>

Atkinson also argued that Albrecht's acceptance of the erroneously paid royalties was actually an acceptance of shut-in royalties which extended the life of the lease. Finding no proof in the record of intent to pay shut-in royalties, or that they were the proper amount, and observing that in any event, they were paid after expiration of the lease, the court held that no shut-in royalties were paid.<sup>198</sup>

Finally the court held that the *force majeure* clause of the lease was not triggered by the Commission's sealing of the well, because the Commission's actions were the result of Atkinson's failure to comply with Commission regulations, and were not the result of "circumstances beyond the reasonable control of the lessee. . . ."<sup>199</sup>

### III. JOINT OPERATIONS

The Fifth Circuit Court of Appeals, in *Norman v. Apache Corp.*,<sup>200</sup> was called upon to construe, as a matter of law, several provisions of a joint operating agreement covering oil and gas working interests located in Brazoria County, Texas.

In 1977, Dow Chemical Company drilled and completed the Sue and Dwight Brothers No. 1 Well on oil and gas leases which were subsequently pooled with other acreage and unitized into production units. The Sue and Dwight Brothers Well was the only well on the Brothers Gas Unit, and the leases within the unit were maintained only by production from that well. In 1976, prior to the completion of the well, the owners of the working interests in the leases had executed a joint operating agreement, giving Dow the exclusive control of the oil and gas operations on the subject leases. In 1982, Apache Corporation took over operations of

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194. *Id.*

195. *Id.*

196. *Atkinson Gas*, 878 S.W.2d at 240.

197. *Id.* The court does not mention ratification as a contractual theory, but it should be noted that a key element of that theory, to-wit, knowledge by Albrecht, both of the fact of termination and of the receipt of royalties for the shut-in period, was established.

198. *Id.* at 241.

199. *Id.*

200. 19 F.3d 1017 (5th Cir. 1994).

the Brothers Gas Unit, subject to the terms of the original 1976 operating agreement.

Apache continued to operate the Brothers Well until July of 1990. At that time, Apache ceased production from the well and Apache employees prepared paperwork showing the well to be "uneconomical to produce"<sup>201</sup> and "not expected to return to production."<sup>202</sup> In September 1990, Apache filed with the Texas Railroad Commission a notice of intention to plug and abandon the Brothers Well, and in late December of that year, recommended to the working interest owners that the well be plugged and abandoned. The owners requested that Apache continue to operate the Brothers Well, but then learned that operations had ceased as of July 1990 and that the leases formerly held by production from the well had been lost. The working interest owners filed suit in 1991, alleging that Apache breached contractual and fiduciary duties under the joint operating agreement by failing to give them advance notice of its decision to plug and abandon the well; by failing to take reasonable actions to prevent the lapse of the Brothers Unit leases; by failing to notify them of cessation of production from the well; and by misrepresenting to them, through the sending of monthly billing statements, that it continued to operate the well after July 1990. The trial court granted a summary judgment in favor of Apache on all claims, and the owners appealed.<sup>203</sup>

The appellate court first held that the lower court correctly found that the working interest owner's complaint did not allege sufficient facts to support a claim of fraud against Apache.<sup>204</sup> The Fifth Circuit then considered whether Apache was entitled to summary judgment on its claims of breach of fiduciary duty. Apache argued that neither the joint operating agreement nor the circumstances surrounding its relationship with the owners could give rise to a fiduciary duty; and that in fact, a letter agreement between the parties expressly negated the existence of a fiduciary relationship.

Applying Texas law,<sup>205</sup> the court found that the letter agreement relied upon by Apache addressed the relationship between Apache and the owners only as it concerned potential liabilities or obligations to third parties.<sup>206</sup> The letter agreement did not, therefore, proscribe the creation

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201. *Id.* at 1019.

202. *Id.*

203. *Id.* at 1021. The trial court granted its summary judgment on the original complaint filed by the working interest owners, after having found that an amended complaint filed by the owner, alleging additional causes of action, was not timely filed. The Fifth Circuit also refused to consider the amended complaint. *Id.* at 1022.

204. *Norman*, 19 F.3d at 1022 (citing FED. R. CIV. P. 9(b), and relying upon *Haber Oil Co. v. Swinehart Co. (In re Haber Oil Co.)*, 12 F.3d 426, 439 (5th Cir. 1994) and *Shushany v. Allwaste, Inc.*, 992 F.2d 517, 521 (5th Cir. 1993)).

205. The case was in federal court on diversity jurisdiction. *Id.* at 1023-24.

206. *Norman*, 19 F.3d at 1024. The pertinent language in the letter agreement stated: The obligations and liabilities of the parties hereto shall be several and not joint or collective, and each party shall be responsible only for his or its obligations in accordance with the terms and conditions of this agreement. This agreement does not constitute or create a joint venture or partnership, min-

of fiduciary duties.<sup>207</sup> The court then cited a number of Texas cases<sup>208</sup> for the proposition that unless specifically set out in the operating agreement, a fiduciary relationship does not arise between the operator and working interest owners by virtue of the contractual joint operations; however, such a relationship may arise from a special relationship between the parties, such as a partnership, agency, or confidential relationship.<sup>209</sup> Because the owners did not assert a partnership or agency relationship with Apache, the court examined the summary judgment evidence for a fact issue with respect to whether a confidential relationship may have existed between the parties. Without defining the elements or nature of a confidential relationship, the court noted that not every relationship involving great trust and confidence is fiduciary in nature, that evidence that a relationship is cordial and of long duration does not evidence a confidential relationship and that mere subjective trust alone is not enough create a confidential relationship.<sup>210</sup> The court then held that the owners had failed to raise a fact issue with respect to the existence of fiduciary duties and so affirmed the holding of the lower court on that issue.<sup>211</sup>

The court next considered the owners' breach of contract claims against Apache. The Fifth Circuit held that the section of the joint operating agreement which addressed delay rentals and shut-in gas well payments applied only to the temporary, and not to permanent, cessation of production from a well.<sup>212</sup> Noting that the provision of the joint operat-

eral or otherwise, or association, or agency or a fiduciary relationship of any kind or character whereby any party hereto shall become liable for the acts and deeds of any other party hereto. . . .

*Id.*

207. *Id.* at 1024.

208. See *Crowder v. Tri-C Resources, Inc.*, 821 S.W.2d 393, 399 (Tex. App.—Houston [1st Dist.] 1991, no writ); *Taylor v. GWR Operating Co.*, 820 S.W.2d 908, 911-12 (Tex.App.—Houston [1st Dist.] 1991, writ denied); *Hamilton v. Texas Oil & Gas Corp.*, 648 S.W.2d 316, 320 (Tex. App.—El Paso 1982, writ ref'd n.r.e.); *Crim Truck & Tractor v. Navistar Int'l Trans. Corp.*, 823 S.W.2d 591, 594 (Tex. 1992); *MacDonald v. Follett*, 142 Tex. 616, 180 S.W.2d 334, 337-38 (1944).

209. *Norman*, 19 F.3d at 1024-25.

210. *Id.* at 1025 (citing *Crim Truck & Tractor v. Navistar Int'l Trans. Corp.*, 823 S.W.2d 591, 595 (citing *Thigpen v. Locke*, 363 S.W.2d 247, 253 (Tex. 1962))).

211. *Id.* at 1026.

212. *Id.* at 1027. With respect to delay rentals and shut-in payments, the joint operating agreement provides:

Operator shall pay all delay rentals and shut-in well payments which may be required under the terms of all leases covered by this agreement and submit evidence of each payment to the other parties. Each party shall notify the other, in writing, at least thirty (30) days prior to the date any rental payment is due, as to whether or not it elects to participate in the payment thereof. In the event either party elects not to participate in a rental payment, and the other party elects to participate therein, then the party desiring not to participate shall promptly execute and deliver to the party desiring to participate in such rental payment an assignment of such non-participating party's right, title and interest in and to such lease, or leases, and such lease, or leases, shall no longer be subject to this agreement. The amount of such payments, when made for the account of both parties, shall be charged by Operator to the joint account of the parties. Operator shall not be liable to the other party in damages for the loss of any lease or interests therein if,

ing agreement which governs abandonment of wells imposes no contractual duty by the operator to notify working interest owners of an intent to abandon or permanently cease production from a well,<sup>213</sup> and citing *Fuller v. Phillips Petroleum Co.*,<sup>214</sup> the court affirmed the lower court's judgment with respect to the owner's claims of breach of contract for failure to notify the owners of the abandonment of the Brothers Well.<sup>215</sup>

Finally, the court considered the owners' claims that Apache failed to act as a reasonably prudent operator. Noting that Texas courts have determined that "in the context of a joint operating agreement, the requirement that Apache conduct all operations—as permitted by, required by, and within the limits of the agreement—in 'a good and workmanlike manner' means that Apache has a duty to perform such operations 'as a reasonably prudent person engaged in drilling oil wells,' i.e., as a reasonably prudent operator."<sup>216</sup> Relying upon *Johnston v. American Cometra, Inc.*,<sup>217</sup> the Fifth Circuit rejected Apache's claim that its obligation to perform in a good and workmanlike manner extends only to the operations expressly required by the joint operating agreement and does not create any independent duties.<sup>218</sup> After reviewing the summary judgment evidence, the court concluded that Apache had not proved, as a matter of law, that it acted as a prudent operator under the specific circumstances

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through mistake or oversight, any rental or shut-in well payment is not paid. There shall be no adjustment of interests of the parties in the remaining portion of the Unit Area in the event of a failure to pay, or erroneous payment of rental or shut-in well payments. If any party secures a new lease covering the terminated interest, such acquisition shall be subject to provisions of Section 23 of this agreement.

Operator shall promptly notify each party hereto of the date on which any gas well located on the Unit Area is shut in and the reason therefor and the date on which said well is restored to production.

*Id.*

213. *Id.* at 1027. With respect to abandonment of wells, the joint operating agreement provides, in pertinent part:

No well, other than any well which has been drilled or reworked pursuant to Section 12 hereof for which the Consenting parties have not been fully reimbursed as therein provided, which has been completed as a producer shall be plugged and abandoned without the consent of all parties; provided, however, if all parties do not agree to the abandonment of any well, those wishing to continue its operation shall tender to each of the other parties its proportionate share of the value of the well's salvable material and equipment . . . less the estimated cost to salvaging and the estimated cost of plugging and abandoning. Each abandoning party shall then assign to the non-abandoning parties, without warranty, express or implied, as to title or as to quantity, quality, or fitness for use of the equipment and material, all of its interest in the well and its equipment, together with its interest in the leasehold estate as to, but only as to, the interval intervals of the formation or formations then open to production. . . .

*Id.*

214. 872 F.2d 655, 658-59 (5th Cir. 1984).

215. *Norman*, 19 F.3d at 1029.

216. *Id.* at 1029 (quoting *Johnston v. America Cometra, Inc.*, 837 S.W.2d 711, 716 (Tex. App.—Austin 1992, writ denied)).

217. 837 S.W.2d 711, 716 (Tex. App.—Austin 1992, writ denied).

218. *Norman*, 19 F.3d at 1030.

of the case, and therefore reversed the judgment of the lower court on this issue and remanded for further proceedings.<sup>219</sup>

#### IV. GAS TRANSPORTATION CONTRACTS

In *Tennessee Gas Pipeline Co. v. Federal Energy Regulatory Comm'n*,<sup>220</sup> the Fifth Circuit Court of Appeals reversed an order of the Federal Energy Regulatory Commission (FERC) which prohibited Tennessee Gas Pipeline Co. from making certain rate changes under a 1991 gas transportation contract with Flagg Energy Development Corporation.<sup>221</sup>

In 1988 and 1989, Tennessee entered into agreements with seven different companies, including Flagg, for the transportation of natural gas to points in the Northeast. In connection with those agreements, Tennessee sought FERC approval to construct and operate new pipeline facilities, and to transport gas to Flagg through new pipeline segments designated by Tennessee as segments U, 2 and 3, and to charge Flagg at rates set forth on a Rate Schedule known as NET-EU. FERC approved the construction of segments 2 and 3, among others, in May of 1990. In that May 1990 order, FERC denied Tennessee's request to charge Flagg for any use of segments which had not yet been approved, but stated that Tennessee could seek to amend its NET-EU rates to include the costs associated with new segments after they were approved and placed in service.

In 1991, Flagg and Tennessee entered into a "Firm Natural Gas Transportation Agreement," which referred to, and was specifically based upon, the May 1990 order. The contract set out a specific rate formula for transporting the gas and also provided that Tennessee had the unilateral right "to file and make effective changes in the rates, charges, and conditions applicable to service."<sup>222</sup> Subsequently, Tennessee filed a limited rate case under section 4 of the Natural Gas Act<sup>223</sup> (NGA) to revise the rates in its NET-EU rate schedule and, among other requests, sought to charge Flagg and another company for use of the segment U pipeline.

Flagg intervened in the rate case, contending in part that its 1991 contract with Tennessee allowed Tennessee to charge it for the use of segments 2 and 3, but not for the use of segment U. In an expedited paper hearing, the FERC found the contract to be clear and unambiguous and determined that it did not allow Tennessee to charge Flagg for the use of the segment U pipeline.

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219. *Id.* at 1031. Note, however, that Judge Eugene Davis dissented in part, arguing that a letter from Apache to plaintiffs established that Apache was entitled to judgment as a matter of law, that it did not breach its obligation to perform in a good and workmanlike manner by failing to notify the owners of its intent to terminate production of the Brothers Well. *Id.* at 1031-32. The letter, however, does not notify the plaintiffs of an intent to plug and abandon the well. Instead, it states Apache's reasons for refusing to plug and abandon as of that date.

220. 17 F.3d 98 (5th Cir. 1994).

221. *Id.* at 99.

222. *Tennessee Gas*, 17 F.3d at 100.

223. 15 U.S.C. § 717 (1988).

The Fifth Circuit first determined that the case must be decided on the basis of the specific wording of the contract.<sup>224</sup> The court relied upon the decision of the United States Supreme Court in *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*,<sup>225</sup> for the rule that the NGA does not allow natural gas companies to unilaterally change rates established by valid contract, and that court's decision in *United Gas Pipe Line Co. v. Memphis Light, Gas and Water Division*,<sup>226</sup> for the rule that natural gas companies may seek unilateral changes in their rates unless a contract expressly precludes them from so doing.<sup>227</sup> In other words, a natural gas company may always seek to alter its rates, unless there is a contractual obligation not to do so. Consequently, the court looked solely to the contract language used by Flagg and Tennessee to determine Tennessee's right to seek a change in the rates charged under the contract.

The court rejected Flagg's argument that it should defer to FERC's construction of the 1991 contract.<sup>228</sup> Declaring it well-settled law within the Fifth Circuit that the court will "review the construction of natural gas contracts freely,"<sup>229</sup> it cited *Mid-Louisiana Gas Co. v. Federal Energy Regulatory Comm'n* and *El Paso Natural Gas Co. v. Federal Energy Regulatory Comm'n* for the rule that it will defer to FERC's construction of natural gas contracts only where FERC has applied its factual or technical expertise in reaching a conclusion. Finding that FERC did not rely on such expertise, the court reviewed the construction of the contract *de novo*.<sup>230</sup>

Again relying on *Mid-Louisiana Gas*,<sup>231</sup> the federal court stated that it should apply the normal rules of contract construction in interpreting a natural gas contract.<sup>232</sup> It held that Texas law<sup>233</sup> requires that a court review an entire contract to determine its meaning, and that meaning, effect and purpose are to be given to each word in the contract if possible.<sup>234</sup> The appellate court then reviewed the two contract provisions primarily at issue.

The contract read, in part, as follows:

8.2. *Transportation Rates*—Beginning on the Commencement Date, the compensation to be paid by Shipper to Transporter for the transportation service provided for herein shall be payable monthly

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224. *Tennessee Gas*, 17 F.3d at 102.

225. 350 U.S. 332 (1956).

226. 358 U.S. 103 (1958).

227. *Tennessee Gas*, 17 F.3d at 102.

228. *Id.* at 102.

229. See *El Paso Natural Gas Co. v. Fed. Energy Regulatory Comm'n*, 881 F.2d 161, 164 (5th Cir. 1989); *Pennzoil Co. v. Fed. Energy Regulatory Comm'n*, 789 F.2d 1128, 1135-36 (5th Cir. 1986).

230. *Tennessee Gas*, 17 F.3d at 102.

231. 780 F.2d at 1242-43.

232. *Tennessee Gas*, 17 F.3d at 102.

233. See *Eagle Life Ins. Co. v. G.I.C. Ins. Co.*, 697 S.W.2d 648, 650 (Tex. App.—San Antonio 1985, writ ref'd n.r.e.).

234. *Tennessee Gas*, 17 F.3d at 103 (citing *TM Prod., Inc. v. Nichols*, 542 S.W.2d 704, 708 (Tex. App.—Dallas 1976, writ ref'd n.r.e.)).

in accordance with Article X hereof and shall be equal to the sum of the following: (a) the product of (1) the sum of the "D-1" charges for Segments 2 and 3 under Transporter's NET-EU Rate Schedule and (2) the Transportation Quantity, (b) the product of (1) the sum of the "D-2" charges for Segments 2 and 3 under Transporter's NET-EU Rate Schedule and (2) the "D-2 Billing Determinant" for the applicable billing period as set forth in Exhibit B hereto, (c) the product of (1) the sum of the "Commodity" charges for Segments 2 and 3 under Transporter's NET-EU Rate Schedule and any applicable surcharges as included in Transporter's effective FERC Gas Tariff and (2) the quantity of gas delivered by Transporter to Shipper during the applicable billing period.

References herein to Transporter's NET-EU Rate Schedule shall include any successor or substitute rate schedules. . . .

. . . .  
 8.4 *Rate Changes*—Shipper agrees that Transporter shall have the unilateral right *pursuant to this Article VIII* to file and make effective changes in the rates, charges, and conditions applicable to service pursuant to the Rate Schedule under which this service is rendered and/or any provisions of the General Terms and Conditions of Transporter's FERC Gas Tariff Volume No. 1 as such Tariff may be revised or replaced from time to time. Without prejudice to Shipper's right to contest such charges, Shipper agrees to pay the effective rate for service rendered pursuant to this Agreement, subject to FERC review and adjustment.<sup>235</sup>

FERC had construed the two sections to mean that Tennessee's right to file revised rates under section 8.4 was limited, by use of the phrase "pursuant to this Article VIII," to the segments of pipeline referred to in section 8.2. FERC argued that "pursuant to" is a restrictive phrase meaning "in conformance or agreement with" or "according to."<sup>236</sup> FERC reasoned that section 8.2 allowed charges only in connection with segments 2 and 3, and not in connection with segment U. If section 8.4 must be read in conformance or agreement with section 8.2, section 8.4 did not allow Tennessee to revise its rates to include charges not provided for in section 8.2, therefore excluding any charges for segment U.

The Fifth Circuit was unpersuaded by both FERC's interpretation of "pursuant to" and its construction of the contract.<sup>237</sup> The court noted that the contract sets forth a formula for charging for the use of segments 2 and 3 based on four variables.<sup>238</sup> The dollar amount of each variable is not determinable by reference to the contract, but requires reference to the NET-EU Rate Schedule, which the contract defined to include any successor or substitute rate schedules.<sup>239</sup> Finding that all references to the NET-EU Rate Schedules in section 8.2 necessarily included revised

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235. *Id.*

236. FERC cited BLACK'S LAW DICTIONARY 1236 (6th ed. 1990).

237. *Tennessee Gas*, 17 F.3d at 104.

238. *Id.*

239. *Id.* The opinion does not set out the specific contract language on which the court relied.

or changed rate schedules, the court held that FERC's interpretation would turn the language of section 8.4 into "mere surplusage."<sup>240</sup> As to the meaning of the phrase "pursuant to," the court held that the definition relied upon by FERC effectively eviscerated section 8.4 from the contract.<sup>241</sup> The court also noted that the definition of "pursuant to" relied upon by FERC was limited to its use in a statute.<sup>242</sup> The court found the proper meaning of "pursuant to" was "in carrying out" or "in the course of carrying out."<sup>243</sup> Finally, the court found its construction of section 8.4 to be consistent with other contract provisions.<sup>244</sup>

Flagg also contended that the contract should be read to allow Tennessee to revise "charges" for segments 2 and 3, but not overall gas transportation rates, such as adding charges for segment U, and that the word "rates" was employed by the parties in a technical sense. In rejecting these arguments, the Fifth Circuit found that such a reading would, again, completely negate section 8.4, and render the word "rates" superfluous.<sup>245</sup> The court also held that there was no evidence that the word "rates" was used in any technical sense and concluded that its construction of the contract did not make section 8.2 meaningless, but instead rendered its provisions temporary; i.e., effective only until Tennessee chose to revise the transportation rates in a manner consistent with the NGA.<sup>246</sup>

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240. *Id.*

241. *Id.*

242. *Id.*

243. *Tennessee Gas*, 17 F.3d at 104-05 (citing WEBSTER'S NEW COLLEGIATE DICTIONARY 930 (1979) and BLACK'S LAW DICTIONARY 1237 (6th ed. 1990)).

244. *Id.* at 105. In particular, the court found that the "pursuant to" language in section 8.4 was intended to remove Article VIII from the terms of section 16.1 of the contract which prohibited modification of any term absent written consent by both parties. *Id.* at 105.

245. *Id.* at 105.

246. *Id.* at 106. The court did not address whether the revisions attempted by Tennessee were in fact consistent with the NGA. *Id.*



