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# OIL, GAS, AND MINERAL LAW

by

Stuart C. Hollimon\*

## I. CONVEYANCING

**I**N *Day & Co. v. Texland Petroleum, Inc.*<sup>1</sup> the Texas Supreme Court, in a landmark decision,<sup>2</sup> changed the law of Texas applicable to the executive right<sup>3</sup> by holding that such is a property right, not a power of appointment, and therefore is conveyed along with the mineral estate under a general warranty deed unless expressly reserved.<sup>4</sup>

Mildred Keaton and Francell Young conveyed eighty acres of land by warranty deed to Day & Company. Keaton and Young reserved an undivided one-half mineral interest, but expressly conveyed the executive right in the entire tract to Day & Company. Day & Company later conveyed ten acres out of the eighty-acre tract to John and Genelda Shoaf by warranty deed, excepting and reserving an undivided one-fourth mineral interest. The deed also excepted the one-half mineral interest previously reserved to Keaton and Young, but was silent as to the executive right to the ten acres. Day & Company and the Shoafs executed separate mineral leases to the same lessee, who later assigned its leases to Texland. Day & Company, believing that Texland's predecessor in interest had failed to pay delay rentals to Keaton and Young in order to maintain its lease covering Keaton and Young's nonexecutive mineral interest, attempted to exercise the executive right to this interest by executing a new lease to Bobby Day, the president of Day & Company.

Day & Company then brought suit against Texland and the Shoafs seeking a judicial declaration that Day & Company owned three-fourths of the executive right to the minerals under the ten-acre tract, and that the lease from Day & Company to Day was valid. The trial court granted Texland's motion for summary judgment, holding that the lease assigned to Texland was valid as to the eighty mineral acres and that the executive right to half the minerals in the ten-acre tract, which had previously been severed and conveyed to Day & Company, passed under the warranty deed to the

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1. 786 S.W.2d 667 (Tex. 1990).

2. On motion for rehearing the supreme court withdrew its previous opinion and judgment. 32 Tex. Sup. Ct. J. 549 (July 12, 1989), *withdrawn*, 786 S.W.2d 667 (Tex. 1990).

3. The executive right is the exclusive power to execute oil and gas leases. 2 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 338 (1990).

4. 786 S.W.2d at 669-70.

Shoafs.<sup>5</sup> Accordingly, the trial court declared the Shoafs to be the holders of an undivided three-fourths interest and Day & Company to be the holder of the remaining one-fourth interest in the executive right.<sup>6</sup> The court of appeals affirmed the lower court's judgment, holding that the executive right severed from Keaton and Young's one-half mineral interest had passed to the Shoafs under the general warranty deed from Day & Company because the executive right was "so significantly and intimately connected with the mineral estate as to be within the general rule that a warranty deed passes all the estate owned by the grantor at the time of the conveyance unless there are reservations or exceptions which reduce the estate conveyed."<sup>7</sup>

On appeal to the supreme court, Day & Company argued that the court of appeals erred in treating the severed executive right as an incident of the mineral estate which can be conveyed by implication as a result of a failure to except the right from the granting clause of a general warranty deed. Relying on the supreme court's decision in *Pan American Petroleum Corp. v. Cain*,<sup>8</sup> Day & Company claimed that a severed executive right was in the nature of a power that could be conveyed only by an express assignment under applicable principles of contract law. In *Cain* the court described the executive right as a power, stating that "a power is an authority given to dispose of real or personal property of which the donor has the right of disposition . . . [and] is not an estate in the property, and its scope and extent is governed by the instrument creating it."<sup>9</sup>

In *Day* the court recanted its analysis in *Cain*<sup>10</sup> and held that the executive right is an interest in property which is incident to and part of the mineral estate, like other attributes such as bonus, royalty and delay rentals.<sup>11</sup> The court overruled its opinion in *Cain* to the extent it conflicted with the *Day* holding.<sup>12</sup> Applying this analysis to the instant case, the court found that the executive right, severed from the one-half mineral interest reserved by Keaton and Young and conveyed to Day & Company, passed under Day & Company's general warranty deed to the Shoafs because Day & Company did not reserve or except such interest from the conveyance.<sup>13</sup>

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5. *Id.* at 667-68.

6. *Id.*

7. 718 S.W.2d 384, 389 (Tex. App.—Amarillo 1986), *aff'd*, 786 S.W.2d 667 (Tex. 1990).

8. 163 Tex. 323, 355 S.W.2d 506 (1962).

9. *Id.*; 355 S.W.2d at 510 (quoting *Hupp v. Union Coal & Coke Co.*, 284 Pa. 529, 530, 131 A. 364, 365 (1925)).

10. According to the Texas Supreme Court:

We erred in *Cain* when we compared the executive right to a power of appointment. Although the executive right is similar to a power, it is not a product of contract, but rather a creature of property rights. Even when it is severed from the other rights or attributes incident to the mineral estate, it remains an interest in property. As the dissent in *Cain* correctly noted, the executive right reserved by the grantor "was a property right, an interest in land appurtenant to the mineral interest therein conveyed, and for the use and benefit of the mineral interest retained and owned by [the grantor]."

786 S.W.2d 667, 669 (Tex. 1990) (citations omitted).

11. *Id.*

12. *Id.*

13. *Id.* at 669-70.

The remaining issue on appeal concerned the validity of the mineral lease between Day & Company and Bobby Day covering the entire eighty acres with respect to the nonexecutive mineral interest owned by Keaton and Young. Although Day & Company had previously leased these minerals to Texland's predecessor in interest, Day & Company claimed that such lease terminated when Texland's predecessor failed to pay Keaton and Young delay rentals. Prior to the lease between Day & Company and Day, however, Keaton and Young accepted late payment of delay rentals and ratified in writing the lease to Texland's predecessor in interest. The supreme court held that the lease to Texland's predecessor in interest was the superior lease because it had been executed, recorded, and revived prior to the lease to Day.<sup>14</sup>

In *Smith v. Williams*<sup>15</sup> the Texas Supreme Court confirmed existing Texas law by holding that the execution of an instrument conveying a note and a lien and "all liens and titles held by the grantor in and to said land" does not as a matter of law convey a severed mineral estate owned by the grantor in the property.<sup>16</sup>

In *Smith Wolcott Gin, Inc.*, a company owned by Terry Smith, conveyed the mineral estate in three tracts of land to Smith. At the same time, Smith sold his stock in the company. The purchaser of the stock executed a promissory note to Smith secured by a deed of trust covering the three tracts. Smith later transferred the note and the lien to the Plains National Bank of Lubbock to secure an unrelated debt. The instrument transferring the lien stated that Smith was transferring the note, the lien, and "all liens and titles held by [Smith] in and to said land."<sup>17</sup> Smith subsequently defaulted on the debt, and the bank foreclosed its lien and purchased the property. The bank later conveyed the land to a third party who sued Smith seeking a declaratory judgment that Smith's transfer of lien also conveyed title to Smith's mineral estate in the land.

In accord with its decisions in *Humphries-Mexia Co. v. Gammon*<sup>18</sup> and *Carminati v. Fenoglio*,<sup>19</sup> the supreme court held that as a matter of law the transfer of the lien assigned the note and the lien reserved to secure it as well as the legal title retained by Smith for the same purpose, but did not convey the mineral estate Smith had reserved.<sup>20</sup> In reaching this conclusion, the court reasoned that the reference to "said land" in the instrument by which Smith transferred the note and the lien to the bank referred to the surface estate to which the lien had attached and did not include the mineral estate, which the lien had never covered.<sup>21</sup>

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14. *Id.* at 670.

15. 786 S.W.2d 665 (Tex. 1990).

16. *Id.* at 666.

17. *Id.* at 665.

18. 113 Tex. 247, 254 S.W. 296 (1923).

19. 267 S.W.2d 449 (Tex. Civ. App.—Fort Worth 1954, writ ref'd n.r.e.).

20. 786 S.W.2d at 666.

21. *Id.*

In *Prairie Producing Co. v. Schlachter*<sup>22</sup> the Texarkana court of appeals held that a certain deed conveyed a mineral interest, not a royalty interest, on the basis that the deed's granting clause, as a matter of law, granted a fee interest in the minerals in place.<sup>23</sup>

This case arose from a 1934 deed executed by Mrs. J. H. Riner and Mr. B. E. Riner and wife, as grantors, to R. R. McDonald, as grantee, conveying an interest in two tracts of land situated in Wood County, Texas. The instrument was entitled "Mineral Deed." The granting clause of the instrument provided that it conveyed "an undivided one-half interest in and to all of the oil, gas and other minerals in and under and that may be produced from the land described."<sup>24</sup>

The interest conveyed under the deed ultimately became vested in eight different parties, six of whom leased their respective undivided interests to Prairie Producing Company in 1986. David and Mona Schlachter ultimately acquired an undivided three-fourths of the interest reserved by the Riners and leased the interest in 1983 to a corporation that they owned. The Schlachters filed suit against Prairie Producing Company seeking a declaratory judgment that the 1934 deed conveyed a royalty interest. Prairie Producing Company counterclaimed, seeking a declaration that the deed conveyed a mineral interest.

The court began its construction of the 1934 deed by noting that the granting clause contained classic language conveying a fee interest in the minerals in place.<sup>25</sup> The court continued by noting the five attributes of a severed mineral estate: 1) the right to explore and develop (the right of ingress and egress); 2) the right to lease (the executive right); 3) the right to receive bonus payments; 4) the right to receive delay rentals; and 5) the right to receive royalty.<sup>26</sup> Of these attributes, the court concluded that all had passed under the 1934 deed except the right to delay rentals and the right to bonus monies.<sup>27</sup> According to the court, the reservation of these attributes was not inconsistent with the conveyance of a mineral interest considering the nature of the rights expressly granted and reserved under the deed.<sup>28</sup> The court emphasized, for example, that the right of ingress and egress for the purpose of mining and drilling, a classic attribute of mineral estate ownership, had been conveyed under the deed, thus indicating an intention to convey a mineral estate.<sup>29</sup> Likewise, the fact that the right to receive rentals and bonuses had been withheld was significant to the court. It reasoned that if the parties had intended to convey a royalty interest under the deed, there would have been no need to reserve rentals and bonuses since the royalty interest does not share in those items unless the conveyance or reservation

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22. 786 S.W.2d 409 (Tex. App.—Texarkana 1990, writ denied).

23. *Id.* at 411.

24. *Id.*

25. *Id.* at 412.

26. *Id.*

27. *Id.*

28. *Id.*

29. *Id.*

specifically provides otherwise.<sup>30</sup>

On these bases, the court held that the clearly expressed intent of the parties contained in the deed's granting clause was determinative of the issue and compelled the conclusion that the deed conveyed a mineral interest and not a mere royalty interest.<sup>31</sup>

*Krenek v. Texstar North America, Inc.*<sup>32</sup> involved an application of the common law "strip and gore" doctrine. The Corpus Christi court of appeals held that the plaintiffs had previously conveyed their interest in a twenty-four-acre strip of land by implication when they conveyed title to the tracts adjoining the strip on either side.<sup>33</sup> In *Krenek* appellants' parents owned a 236-acre tract of land. By two separate conveyances, one in 1965 and the other in 1967, appellants' parents conveyed the surface of a twenty-four-acre strip to the State of Texas for use as a highway, waiving all rights of ingress and egress to the surface but retaining the mineral interest underlying the strip. The twenty-four-acre strip ran through the center of the 236-acre tract and eventually became part of Highway 59. In 1971, the appellants' mother died testate (their father having predeceased her). In her will, she devised the 106.88 acres lying west of Highway 59 to her son Victor and the 105.03 acres lying east of Highway 59 to her daughter Dorothy. The mineral estate underlying the twenty-four-acre strip was not expressly devised. Victor, acting as the executor of his mother's estate, executed deeds to himself and to his sister conveying the acreage described in the will. The mineral interest to the twenty-four-acre strip was not conveyed by either deed. Victor and Dorothy subsequently conveyed the surface and minerals of their tracts by deeds containing metes and bounds descriptions to the edge of the highway. Texstar acquired a lease on the 106.88-acre tract and drilled a producing well. Thereafter, Victor and Dorothy sued Texstar for drainage of the twenty-four-acre strip, alleging ownership of the underlying minerals.

The strip and gore doctrine is a well-established rule of common law in Texas which provides that, absent an express reservation to the contrary, a conveyance of land bounded by a public highway carries with it the fee to the center of the road as part of the grant.<sup>34</sup> This presumption of intent to convey title to the center of the highway applies if the appurtenant strip exists at the time of the conveyance and is not overcome by the fact that the deed describes the abutting land by metes and bounds extending to the edge of the highway.<sup>35</sup> The doctrine does not apply, however, if the grantor owns land abutting both sides of the strip<sup>36</sup> or if the strip is larger and more valuable than the conveyed tract.<sup>37</sup>

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30. *Id.* at 412-13.

31. *Id.* at 414.

32. 787 S.W.2d 566 (Tex. App.—Corpus Christi 1990, writ denied).

33. *Id.* at 569.

34. *Id.* at 568; see also *State v. Williams*, 161 Tex. 1, 335 S.W.2d 834, 836 (1960); *Goldsmith v. Humble Oil & Refining Co.*, 145 Tex. 549, 199 S.W.2d 773, 775 (1947).

35. 787 S.W.2d at 568-69; see also *State v. Williams*, 335 S.W.2d at 836.

36. 787 S.W.2d at 569; see also *Rio Bravo Oil Co. v. Weed*, 121 Tex. 427, 50 S.W.2d 1080, 1083 (1932), *cert. denied*, 288 U.S. 603 (1933).

37. 787 S.W.2d at 569; see also *Angelo v. Biscamp*, 441 S.W.2d 524, 527 (Tex. 1969).

The court of appeals applied the strip and gore doctrine and concluded that Victor and Dorothy had conveyed the twenty-four mineral acres underlying the highway when they conveyed the adjoining acreage lying on either side of the highway, and therefore had no standing to assert a claim against Texstar for drainage.<sup>38</sup> The court reasoned that: 1) the deeds executed by Victor and Dorothy conveyed tracts abutting an existing highway using a metes and bounds description to the edge of the highway; 2) the abutting tracts did not have a common grantor at the time of those conveyances because Victor owned the acreage west of the highway and Dorothy owned the acreage east of the highway; and 3) the twenty-four-acre strip was not larger than the conveyed tracts.<sup>39</sup> Having considered these factors, the court held, as a matter of law, that appellants had conveyed the strip when they conveyed the abutting acreage, and therefore owned no mineral interest that could be drained by Texstar.<sup>40</sup>

*Luckel v. White*<sup>41</sup> involved the construction of a future lease clause contained in a 1935 royalty deed. Under the deed, Mary Etta Mayes granted to L. C. Luckel, Jr., his heirs and assigns, an undivided 1/32nd royalty interest in and to a certain tract of land. The grant was made subject to an existing oil and gas lease and provided that the grantee was entitled to 1/4th of any and all royalties paid under such lease. The deed further provided that Mayes reserved the executive right as well as the right to all bonuses and rentals paid under any future oil and gas leases. The deed expressly stated, however, that Luckel was "entitled to one-fourth of any and all royalties reserved under [any future] leases."<sup>42</sup> Subsequent leases covering the property provided for a 1/6th royalty, rather than 1/8th, as provided in the lease existing at the time of the grant. Mayes' successors in interest claimed that under these leases, Luckel's successors were entitled to a 1/32nd undivided royalty interest. Luckel's successors, on the other hand, asserted entitlement to a 1/24th royalty interest under such leases.

The granting clause in the royalty deed clearly conveyed an undivided 1/32nd royalty interest.<sup>43</sup> The future lease clause was, however, capable of being interpreted as entitling the grantee to a different royalty interest in future leases than that conveyed in the granting clause.<sup>44</sup> In *Alford v. Krum*<sup>45</sup> the Texas Supreme Court faced a similar conflict between a granting clause and a "future lease" clause in a mineral deed. In that case the supreme court held that the granting clause was the controlling provision defining the estate conveyed.<sup>46</sup> Thus, if the *Luckel* deed's granting clause and future lease clause were construed to be irreconcilable, the grant of

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38. 787 S.W.2d at 569.

39. *Id.*

40. *Id.*

41. 792 S.W.2d 485 (Tex. App.—Houston [14th Dist.] 1990, writ granted).

42. *Id.* at 487.

43. *Id.* at 488.

44. *Id.*

45. 671 S.W.2d 870 (Tex. 1984).

46. *Id.* at 872.

1/32nd royalty interest in the granting clause would control and Luckel's successors would be entitled to 1/32nd royalty interest in future leases.

In *Luckel* the court did not determine whether the two clauses at issue were in conflict, but instead harmonized the granting clause and the future lease clause.<sup>47</sup> The court cited the judicially noticed fact that the customary landowner's royalty was 1/8th,<sup>48</sup> and that this practice was so common that Texas courts had taken judicial notice of this fact.<sup>49</sup> From this, the court inferred that the parties to the royalty deed intended for all future leases to provide for the usual and customary 1/8th landowner's royalty.<sup>50</sup> Under this interpretation, the future lease clause was in harmony with the granting clause.<sup>51</sup> The future lease clause simply confirmed that the grantee had a 1/32nd royalty interest, being 1/4th of the usual and customary 1/8th royalty interest.<sup>52</sup> The court held as a matter of law that the royalty deed conveyed a 1/32nd royalty interest, and the future lease clause had no effect on that conveyance.<sup>53</sup>

In *Clark v. Amoco Production Co.*<sup>54</sup> the plaintiffs sought to recover from four oil companies the value of a 1/8th interest in billions of dollars worth of oil and gas produced from the prolific Spindletop Field in East Texas. Plaintiffs Clark and Profitt were the administrators of the estate of James R. Meadors, who died in 1939. Meadors was the grantee under a 1911 deed which purported to convey an undivided 1/8th interest in and to four specifically-described tracts of land.<sup>55</sup> The oil company defendants had not produced any oil or gas from the four described tracts; however, they had produced vast quantities of oil from other tracts that were once owned by the McFadden family. The plaintiffs contended that the 1911 deed conveyed to Meadors not only a 1/8th interest in the four described tracts, but also a like interest in all lands in Jefferson County once owned by the McFaddens.

The trial court granted summary judgment in favor of the oil companies.<sup>56</sup> It held that the 1911 deed unambiguously conveyed an interest only in the four described parcels of land, and that the undisputed evidence established

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47. 792 S.W.2d at 490.

48. *Id.*

49. *Id.* (citing *Garrett v. Dils Co.*, 157 Tex. 92, 299 S.W.2d 904, 907 (1957); *King v. First Nat'l Bank of Wichita Falls*, 144 Tex. 583, 192 S.W.2d 260, 262 (1946); *Badger v. King*, 331 S.W.2d 955, 958 (Tex. Civ. App.—El Paso 1959, writ ref'd n.r.e.)).

50. 792 S.W.2d at 490.

51. *Id.*

52. *Id.* at 490-91.

53. *Id.* at 491.

54. 908 F.2d 29 (5th Cir. 1990).

55. In addition, the deed stated that the described property is all the property that . . . J.H. McFadden, R.D. McFadden, and A.J. McFadden inherited through their ancestor, Wm. McFadden, and this deed is intended to convey to the said James Meadors one-eighth's interest in and to all properties . . . that the said J.H. McFadden, A.J. McFadden, and R.D. McFadden are entitled to by inheritance through their ancestor, the said Wm. McFadden, of every description whatsoever, situated in the said County of Jefferson.

*Id.* at 31 n.3.

56. *Id.* at 31.



that the oil companies never owned any interest in, or produced oil or gas from, those properties.<sup>57</sup> The plaintiffs appealed, contending that the deed was ambiguous as to the property conveyed, and that the trial court erred in failing to consider extrinsic evidence to resolve the ambiguity.

The Fifth Circuit affirmed the summary judgment, holding that the deed unambiguously reflected an intent to convey an interest in only the four specifically-described tracts.<sup>58</sup> Since the deed was unambiguous, the trial court properly excluded extrinsic evidence of the parties' intent.<sup>59</sup> Moreover, such evidence cannot be admitted in order to create an ambiguity where none exists.<sup>60</sup>

## II. OIL, GAS AND MINERAL LEASES

### A. Surface/Mineral Relationship

The broad scope of a lessee's right to utilize the surface for the purpose of producing oil, gas and other minerals was recently affirmed in *Property Owners of Leisure Land, Inc. v. Woolf & Magee, Inc.*<sup>61</sup> The Tyler court of appeals held that a unit operator was entitled to construct a road across the surface of a portion of unitized acreage in derogation of certain residential subdivision deed restrictions which were created subsequent to the severance of the mineral estate.<sup>62</sup> In this case, the mineral lessee of a tract of land that included two subdivision lots pooled its acreage with that of other lessees to form an oil unit. The unit operator obtained a permit from the Railroad Commission to drill a well on land located within the unit but outside the acreage covered by the subdivision. As a condition to granting the well permit, however, the Railroad Commission required the unit operator to establish an emergency evacuation route since the well was expected to produce hydrogen sulfide gas. In order to comply with the Railroad Commission's order, the operator constructed a limestone road with culverts across the subdivision lots. Subdivision restrictions, however, prohibited the lots from being used for "a street, access road or public thoroughfare" and further restricted the use of the lots to single-family residential purposes. These deed restrictions were imposed on the subdivision lots in 1968, subsequent to the severance of the mineral estate.

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57. *Id.*

58. According to the court:

The deed initially states that "the property herein conveyed . . . is four (4) tracts." It then provides a legal description of those four properties and further explains, more generally, that "the above-described property herein conveyed is all the property" that the McFaddens inherited from William McFadden. Finally, and somewhat redundantly, the deed adds that it is intended to convey a 1/8th interest in all the lands inherited by the McFaddens from William McFadden—a term already defined within the instrument as equal to the four described tracts.

*Id.* at 32.

59. *Id.*

60. *Id.*

61. 786 S.W.2d 757 (Tex. App.—Tyler 1990, no writ).

62. *Id.* at 760.

Property owners in the subdivision filed suit seeking a declaratory judgment that the emergency road was unrelated to the mineral interest owner's right of access, that it was not a permissible use of the surface, and that it was an excessive use violating the subdivision deed restrictions. The trial court rendered judgment for the unit operator.<sup>63</sup> The court of appeals affirmed, holding that the mineral owner, having the dominant estate, cannot be limited by subdivision restrictions imposed by surface owners after the severance of the mineral estate.<sup>64</sup> Since the restrictive covenants were imposed after the severance of the minerals from the subdivision surface, the court reasoned that they could not be determinative of the scope of the implied surface easements that are incidental to the ownership of the minerals.<sup>65</sup> Furthermore, the court held that evidence that the emergency evacuation road burdened the surface owners and their preferences regarding use of the surface was irrelevant<sup>66</sup> and failed to establish that the unit operator's use of the surface was not reasonably necessary for the production and removal of oil, gas and other minerals.<sup>67</sup> The court concluded that establishing the emergency evacuation route was in fact essential to the production of hydrocarbons since the Railroad Commission conditioned its approval of the drilling permit applicable to the well at issue upon the formation of the route.<sup>68</sup>

## B. Lessee/Lessor Relationship

### 1. Lease Provisions

In *Riley v. Meriwether*<sup>69</sup> the El Paso court of appeals held that the mineral estate created under a Corrected Assignment which did not have a shut-in royalty clause terminated upon a thirteen-month cessation of production due to lack of a market for the production.<sup>70</sup> In this case, separate leases covering nine different tracts were made the subject of a Corrected Assignment. Neither the Corrected Assignment nor the two assignments which preceded it contained shut-in royalty clauses, although the underlying leases included such provisions. The Corrected Assignment provided that it would terminate if a new well was not commenced within ninety days after the cessation of a specified drilling program or if at least one of the tracts was not producing gas within sixty days following the completion of the last well in the program. The jury found that there had been neither production from nor operations for production on the tracts covered by the Corrected Assignment during the relevant period, and that during the time the wells were shut-in it was possible to produce gas in paying quantities.<sup>71</sup> Based on these

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63. *Id.* at 758.

64. *Id.* at 760.

65. *Id.*

66. *Id.*

67. *Id.*

68. *Id.* at 761.

69. 780 S.W.2d 919 (Tex. App.—El Paso 1989, writ denied).

70. *Id.* at 926.

71. *Id.* at 921-22.

findings the court of appeals affirmed the trial court's judgment terminating the mineral interest involved.<sup>72</sup> Noting the lessee's admission that the lack of production was caused because of a lack of market, the court held that non-availability of a market was not an effective excuse for failure to produce oil or gas from the tracts in the absence of an appropriate savings provision.<sup>73</sup>

The El Paso court addressed several points of error, one of which is of particular interest. The lessee asserted that the Corrected Assignment had incorporated by reference the underlying leases, including their shut-in royalty provisions, and that the assignee under the Corrected Assignment had tendered shut-in royalty in accordance with those provisions in a manner sufficient to perpetuate the leases and the estate created by the Assignment. The language of the Corrected Assignment relevant to this issue provided that "[r]eference for all purposes is made to the oil and gas leases described in Exhibit A attached hereto and incorporated herein by this reference."<sup>74</sup> In rejecting the notion that this language incorporated the shut-in royalty provisions of the leases into the Corrected Assignment by reference, the court stated that to accept this proposition would have required a conclusion that this language incorporated portions of six separate and different lease instruments, a matter not clearly expressed by the assignment provision at issue.<sup>75</sup> Instead, the court held that the language quoted above did not incorporate the provisions of each lease, but merely incorporated the exhibit as describing the leases involved.<sup>76</sup> Thus, the court concluded that the shut-in royalty payments tendered did not have the effect of perpetuating the term of the Corrected Assignment, which itself had no provisions for shut-in royalty payments.<sup>77</sup>

The recent Fifth Circuit decision in *Cobb v. Natural Gas Pipeline Co. of America*<sup>78</sup> held that cessation of production from a gas well for a period of nine months resulting from the well's inability to "buck" line pressure constituted a temporary, rather than permanent, cessation of production that, as a matter of law, did not cause the termination of the underlying oil, gas and mineral lease.<sup>79</sup> In *Cobb* the lessors sought a declaratory judgment that a 1917 oil, gas and mineral lease had terminated due to periods of non-production in 1947, 1962, and 1974. The lessors also sought damages for the lessee's alleged conversion of gas following the termination of the lease. The lease involved produced gas in paying quantities at all times since 1928 except for a nine-month period in 1946-47, a three-month period in 1962, and a nine-month period in 1974-75.

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72. *Id.* at 927.

73. *Id.* at 923 (citing *Gulf Oil Corporation v. Reid*, 161 Tex. 51, 337 S.W.2d 267, 270 (1960)).

74. 730 S.W.2d at 924.

75. *Id.*

76. *Id.*

77. *Id.* at 924-25.

78. 897 F.2d 1307 (5th Cir. 1990).

79. *Id.* at 1309-12.

The trial court rendered judgment that the cessation of production in 1974-75 constituted a permanent cessation which caused the lease to terminate by its own provisions.<sup>80</sup> Uncontroverted expert testimony presented by the lessee established that the cause for each cessation of production was a decline in wellhead pressure or an increase in pipeline pressure, or some combination thereof. In each instance, the cessation of production was remedied either by boosting the wellhead pressure through the installation of compressor units or by decreasing pipeline pressure downstream through the construction of additional pipeline laterals serving wells that otherwise would have been forcing gas into the lateral serving the lease at issue. In addition, testimony indicated that the cessation of production was remedied within a reasonable period of time.

Reciting well-established Texas law on the subject, the Fifth Circuit stated that in order to prevent the termination of a lease under the temporary cessation doctrine, the lessee has the burden of establishing that the cessation of production results from a sudden stoppage of the well or some mechanical breakdown of the equipment used on the well and that the lessee remedied the problem and resumed production within a reasonable time.<sup>81</sup> Based on the uncontroverted testimony, the court held that the cessation of production due to line pressure problems qualified as a sudden stoppage of the well within the meaning of the temporary cessation doctrine.<sup>82</sup> The court further held that, in the absence of any challenge, the expert testimony presented by the lessee established that it had proceeded with due diligence to remedy those problems and restore production.<sup>83</sup>

In *Cox v. Stowers*<sup>84</sup> the Amarillo court of appeals held that a lease had not terminated even though it had not produced gas in paying quantities for fifteen months. The court held that the operator's continuous good faith effort to restore production during the period of non-production by administering fluid treatments to the well constituted reworking operations within the meaning of the lease's "sixty-day clause."<sup>85</sup> This case arose under a 1947 oil, gas and mineral lease. The lease was maintained by production from a single gas well. Except for minimal amounts of production in January, April and May 1985, no gas was produced from the well from December 1984 until April 1986. The lessor filed suit seeking termination of the lease on the basis that it had ceased to produce in paying quantities and no drilling or reworking operations had been conducted on the property during the months at issue.

The case was tried without a jury. The only witness to testify with regard to the merits of the case was the lease operator. In summary, he testified

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80. *Id.* at 1308.

81. *Id.* at 1309 (citing *Watson v. Rochmill*, 137 Tex. 565, 155 S.W.2d 783, 784 (1941)).

82. 397 F.2d at 1311-12.

83. *Id.*

84. 786 S.W.2d 102 (Tex. App.—Amarillo 1990, no writ).

85. *Id.* at 106. The relevant clause provided: If after discovery of oil or gas the production thereof should cease from any cause, this lease shall not terminate if lessee commences additional drilling or reworking operations within sixty (60) days thereafter. *Id.*

that the well had ceased to produce in December 1984 and that the fluid treatment process administered by him to the well was, based upon his considerable experience, the correct method to use in treating and restoring the well to productive status and that the waiting periods and procedures followed by him were necessary in the course of that treatment. The trial court rendered judgment for the lessee and the court of appeals affirmed.<sup>86</sup>

In analyzing whether the lease had terminated, the court of appeals defined "reworking operations" as used in the lease's sixty-day clause to mean "any and all actual acts, work or operations in which an ordinarily competent operator, under the same or similar circumstances, would engage in a good faith effort to cause a well or wells to produce oil or gas in paying quantities."<sup>87</sup> Applying this standard, the court of appeals concluded that the trial court was justified in finding that the operator's activities which were commenced within sixty days from the cessation of production and continued until restoration of substantial production from the well were sufficient to constitute good faith reworking activities.<sup>88</sup>

*Presnal v. TLL Energy Corporation*<sup>89</sup> addressed the enforceability of a liquidated damages provision in an oil, gas and mineral lease. In 1983, the Presnals leased a 115-acre tract to TLL's predecessor in interest. The lease obligated the lessee to drill the maximum number of wells allowable on the tract, but in no event less than one well. The parties to the lease expressly recognized that the Texas Railroad Commission field rules applicable to the lease provided for 160-acre spacing. The lease, however, further provided:

[I]n the event the field rules should change to allow a unit of 80 acres, then in such event Lessee shall have 45 days . . . to commence drilling another well . . . and failure of Lessee to so commence drilling shall terminate this lease as to such 80 acres . . . and Paragraph 42 hereof shall apply to the Lessee's failure to commence drilling.<sup>90</sup>

Paragraph forty-two of the lease provided:

Failure of Lessee or Lessee's assigns hereunder to commence drilling hereunder within the lease period shall entitle Lessor to recover from Lessee and any assigns hereunder, as liquidated damages, the sum of \$75,000.00<sup>91</sup>

One of TLL's predecessors in interest drilled a well on the property and included the lease in a 160-acre unit as prescribed by the Texas Railroad Commission. Thereafter, the lease was assigned to TLL and the Commission amended the applicable field rules to permit eighty-acre spacing. TLL did not drill a second well on the lease.

The Presnals sued TLL claiming that it was bound to drill the second well or pay \$75,000 liquidated damages. TLL obtained a summary judgment in

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86. *Id.*

87. *Id.* at 105; *cf.* *Rogers v. Osborne*, 152 Tex. 540, 261 S.W.2d 311, 313-14 (1953); *Phillips Petroleum Co. v. Rudd*, 226 S.W.2d 464, 466 (Tex. Civ. App.—Texarkana 1949, no writ).

88. 786 S.W.2d at 106.

89. 788 S.W.2d 123 (Tex. App.—Houston [1st Dist.] 1990, writ denied).

90. *Id.* at 124.

91. *Id.*

the trial court on the grounds that the liquidated damages clause was unenforceable as a penalty. The Presnals appealed.

According to *Stewart v. Basey*,<sup>92</sup> the leading Texas case on liquidated damages, an agreement made in advance of breach fixing the damages therefor is not enforceable as a contract and does not affect the damages recoverable for the breach unless (a) the amount so fixed is a reasonable forecast of just compensation for the harm that is caused by the breach, and (b) the harm that is caused by the breach is one that is incapable or very difficult of accurate estimation.<sup>93</sup> The time for determining reasonableness of a liquidated damages provision is at the time of the making of the contract and not at the time of the breach.<sup>94</sup> In order for TLL to be entitled to summary judgment, it must have established that (a) \$75,000 was not a reasonable forecast of damages at the time the lease was executed, or (b) damages could have been accurately estimated without difficulty at that time. TLL presented no evidence in this regard.<sup>95</sup> Accordingly, the court of appeals reversed and remanded the cause, holding that TLL failed to conclusively prove that the liquidated damages provision was a penalty.<sup>96</sup>

## 2. Implied Covenants

In *Shelton v. Exxon Corp.*<sup>97</sup> the district court awarded the royalty-owner plaintiff \$10.7 million for Exxon's failure to market gas prudently.<sup>98</sup> The King Ranch, as a co-owner of certain minerals along with Shelton, retained the exclusive executive right over leases, including the exclusive right to enforce the obligations of the leases. Prior to enactment of the Natural Gas Policy Act of 1978 (NGPA),<sup>99</sup> Shelton became disenchanted with the method of royalty payments from Exxon. Although both Exxon and the King Ranch knew of Shelton's complaints, the King Ranch and Exxon settled all claims between themselves in 1980 for additional royalties which accrued before September 1, 1980.

The court upheld the binding effect of the 1980 settlement agreement on Shelton by holding that the reservation of the executive right was not void or ineffective,<sup>100</sup> that the power was irrevocable,<sup>101</sup> and that no conflict existed between the King Ranch and Shelton which rendered the King Ranch unable to negotiate on behalf of Shelton.<sup>102</sup> The court, however, held that the 1980 settlement agreement did not purport to settle Shelton's imprudent

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92. 150 Tex. 666, 245 S.W.2d 484 (1952).

93. *Id.* at 486.

94. 788 S.W.2d at 127 (citing *Williams v. Beasley*, 300 S.W. 193, 195 (Tex. Civ. App.—Eastland 1927, writ ref'd)).

95. *Id.*

96. *Id.*

97. 719 F. Supp. 537 (S.D. Tex. 1989).

98. *Id.* at 538.

99. 15 U.S.C. §§ 3301-3432 (West 1982 & Supp. 1991).

100. 719 F. Supp. at 542.

101. *Id.*

102. *Id.* at 545.

marketing claim against Exxon after September 1, 1980.<sup>103</sup> Shelton claimed that Exxon failed to market prudently the King Ranch gas immediately before enactment of the NGPA by continuing to market the gas to purchasers under long-term warranty contracts. Shelton argued that Exxon should have dedicated the gas to new contracts at prices that would have allowed the gas to be classified under NGPA section 105(b)(2)<sup>104</sup> upon enactment of the NGPA and failure to do so was a breach of Exxon's implied duty to market prudently.

Brushing aside Exxon's estoppel defenses,<sup>105</sup> the court focused on Exxon's argument that a reasonable, prudent operator would not have entered into the contracts as proposed by Shelton because it would have been costly to use high-priced gas purchased on the open market to fill Exxon's warranty contracts. The court agreed with Shelton's protests that those costs were unrelated to the King Ranch leases, arose from Exxon's overall, company-wide marketing plan, and represented risks inherent to long-term warranty contracts.<sup>106</sup> The court held that the reasonable, prudent operator standard should not be reduced for Shelton simply because Exxon had warranty contracts legally unrelated to the King Ranch leases.<sup>107</sup> Exxon was required to market the gas in a manner most reasonably profitable for the mineral interest owners and for Exxon's operations.<sup>108</sup>

Although the court noted that the possible benefits in 1978 of the hypothetical contracts were uncertain, Exxon could have gained those significant benefits for the mineral interest owners without itself incurring costs related to the King Ranch and without subjecting the mineral interest owners to any risks.<sup>109</sup> The court held that prudent marketing required Exxon to do so, and its failure could only be attributed to Exxon's interest in fulfilling its warranty contracts without having to purchase gas on the open market.<sup>110</sup> Exxon's method of marketing the subject gas completely subordinated the rights of the mineral interest owners to Exxon's financial gain.<sup>111</sup> Those acts, the court concluded, were not those of a reasonable, prudent operator having its own and the plaintiff's interests in mind.<sup>112</sup>

The court awarded Shelton \$10.7 million in damages for underpayment of royalty, calculated as the difference between the royalties paid him and those that would have been paid under market value contracts.<sup>113</sup> The court further awarded pre-judgment interest and attorneys' fees of one-third of the amount of total recovery of principal and pre-judgment interest.<sup>114</sup>

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103. *Id.* at 547-48.

104. 15 U.S.C. § 3315.

105. 791 F. Supp. at 546.

106. *Id.* at 548.

107. *Id.* at 549.

108. *Id.*

109. *Id.*

110. *Id.*

111. *Id.*

112. *Id.*

113. *Id.* at 550.

114. *Id.* at 550-51.

## III. GAS PURCHASE CONTRACTS

In *Houston Pipe Line Co. v. BHP Petroleum (Americas), Inc.*<sup>115</sup> the Houston court of appeals applied the provisions of FERC Order Number 399<sup>116</sup> in holding that BHP was not required to refund to Houston Pipe a portion of the proceeds received from the sale of gas.<sup>117</sup> The dispute focused upon the sale of gas under a 1976 contract during the period from January 1, 1981, through June 30, 1983. During that time, Houston Pipe paid BHP for the gas based upon a certain price per million Btu's (MMBtu's)<sup>118</sup> and calculated the heating content of the gas on the basis of "dry" conditions at which the gas was delivered. The price paid by Houston Pipe was determined pursuant to annual redetermination agreements which fixed the contract price for each year involved at the NGPA ceiling price in effect for the month of January of each such year. Thus, the price per MMBtu under the redetermination agreements was fixed at \$2.667 for 1981, \$3.003 for 1982, and \$3.299 for 1983. In contrast, the NGPA ceiling prices in effect for the gas escalated each month.

At times relevant to the lawsuit, the NGPA provided for maximum lawful prices per MMBtu for various categories of natural gas. The Federal Energy Regulatory Commission (FERC) promulgated rules for measuring the Btu content of gas, which at one time required that such content be measured under "dry" conditions, but which in 1983 were amended to require that the Btu content of gas be measured by reference to water-vapor saturated "wet" conditions.<sup>119</sup> Use of the wet rule resulted in a slightly lower Btu content than that obtained by use of the dry rule. The lower Btu content, in turn, lowered the maximum amount of revenues that could be collected under the NGPA for a particular volume of gas.<sup>120</sup> In addition, the FERC required that the wet rule be applied retroactively.<sup>121</sup> As a result, some producers found that they had overcharged gas purchasers.<sup>122</sup> Pursuant to FERC Order No. 399, gas producers were required to refund those overcharges.<sup>123</sup> In this case, upon the adoption of the wet rule and the issuance of the refund

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115. 785 S.W.2d 398 (Tex. App.—Houston [14th Dist.] 1988, no writ).

116. 49 Fed. Reg. 37,735 (1984). The relevant provisions of Order 399 provide that: [A]ny first seller that collected revenues in excess of the product of (a) the applicable maximum lawful price established by the NGPA, and (b) the quantity of MMBtu's (million Btu's) determined on the basis of the wet rule (i.e., under standard test conditions) must refund any such excess revenues. To the extent that revenues collected for gas sold in a first sale under the NGPA are less than or equal to the level of revenues thus calculated, and are contractually authorized, no excess revenues would have been collected, and no refunds are due.

*Id.* at 37,737.

117. 785 S.W.2d at 398.

118. "A 'Btu' (British thermal unit) is the standard of measurement of the energy content of natural gas." 785 S.W.2d at 398.

119. See Interstate Natural Gas Ass'n of America v. Federal Energy Regulatory Comm'n, 716 F.2d 1 (D.C. Cir. 1983), *cert. denied*, 465 U.S. 1108 (1984) (explaining history of FERC's Btu measurement rules).

120. 785 S.W.2d at 399.

121. FERC Order 399, 49 Fed. Reg. 37,735, 37,737 (1984).

122. 785 S.W.2d at 399.

123. 49 Fed. Reg. 37,735, 37,737 (1984).



order, Houston Pipe determined that it had been overcharged during the thirty-month period at issue and invoiced BHP for a refund. BHP refunded \$97,884.71, but later decided that it should have refunded only \$15,901.43. When Houston Pipe disagreed and refused to return the difference, BHP filed suit.

In this instance, the court determined that although the maximum lawful price under the NGPA for the gas at issue escalated on a monthly basis, the contract price at issue escalated only once each year at the time of the annual price redetermination.<sup>124</sup> As a result, the contract price exceeded the maximum lawful price only during the first few months of each year, and therefore, refunds were due only with regard to those months.<sup>125</sup> Houston Pipe, however, contended that the FERC orders requiring calculation of Btu's on a wet basis effectively reduced the NGPA ceiling price, and by operation of the contract and price redeterminations, likewise reduced the redetermined contract prices, thereby reducing the revenues that BHP was contractually entitled to receive. The court rejected this argument, reasoning that the NGPA ceiling prices were not amended by the FERC orders.<sup>126</sup> Instead, the court held that those orders changed only the method for measuring Btu's for NGPA purposes, and this change, although reducing the total amount of revenues that could legally be collected, did not reduce the maximum lawful price chargeable for gas.<sup>127</sup>

In *Dorchester Master Limited Partnership v. Bullock*<sup>128</sup> gas producers sued to recover gas production taxes paid under protest. Dorchester produced gas from wells and sold the gas to an interstate pipeline company pursuant to a 1952 gas contract. Prior to delivery to the pipeline, Dorchester processed the gas, removing certain substances at its plant as authorized by the gas contract. The contract provided for a price of \$0.30 per Mcf, and a minimum heating value of 1,000 Btu per cubic foot.

In 1977, Dorchester and the pipeline amended the contract so as to permit Dorchester to extract additional substances from the gas, which would have the effect of reducing the heating content of the residue gas to less than 1,000 Btu per cubic foot. As compensation for this reduction, the parties agreed that Dorchester would furnish additional gas from other sources in an amount necessary to raise the average heating content of all gas delivered to 1,000 Btu per cubic foot.

The Texas State Comptroller audited Dorchester following the amendment and determined that Dorchester owed taxes and penalties relating to production under the contract. According to the Comptroller, gas production taxes should have been paid on the basis of \$0.27 per Mcf. This figure was derived by reducing the original contract price of \$0.30 per Mcf in proportion to the reduction in Btu content (900/1,000). Dorchester contested

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124. 785 S.W.2d at 400.

125. *Id.*

126. *Id.* at 401.

127. *Id.*

128. 794 S.W.2d 554 (Tex. App.—Austin 1990, writ denied).

this reasoning and claimed that the taxes were due on the market price of the gas as calculated by subtracting from the contract price the production and marketing costs, including the costs of purchasing the make-up gas. The trial court granted summary judgment that Dorchester take nothing.<sup>129</sup>

Under the Texas Tax Code<sup>130</sup> each producer is obligated to pay a gas production tax at the rate of 7.5 percent of the market value of gas produced and saved in Texas by the producer.<sup>131</sup> According to the Code, the market value is the value of the gas at the mouth of the well.<sup>132</sup> In the absence of bad faith, fraud or collusion, the value of the gas is presumed to be the negotiated contract price between the gas producer and the purchaser.<sup>133</sup> The court noted that the tax base may, however, be altered by other factors.<sup>134</sup> "If gas is not sold at the well-head, the costs of transportation and processing, incurred downstream from the wellhead, are deducted in determining the sale price."<sup>135</sup> Additionally, marketing costs, including costs for compressing, treating, and transporting the gas, are deductible from the producer's gross receipts.<sup>136</sup>

Because there was no claim that the contract was other than an arm's-length agreement, the tax base was held to be the \$0.30 per Mcf contract price.<sup>137</sup> From this amount, Dorchester was entitled to deduct the cost of the make-up gas.<sup>138</sup> The court noted that if Dorchester did not add the make-up gas to the residue gas, the gas would not meet the minimum heating quality requirements under the contract.<sup>139</sup> The court reasoned that, by adding the make-up gas, Dorchester was treating the rest of the gas by increasing the total Btu content.<sup>140</sup> Accordingly, the cost of such make-up gas was held to be a marketing cost.<sup>141</sup> The court of appeals therefore reversed the judgment of the district court, and remanded the cause with instructions to render judgment for Dorchester in accordance with the parties' previous stipulations of the amount to be refunded to Dorchester if its calculations were held to be correct.<sup>142</sup>

#### IV. POOLING

In *Pend Oreille Oil & Gas Co. v. Railroad Commission*<sup>143</sup> the Corpus Christi court of appeals held that the Railroad Commission's pooling au-

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129. *Id.* at 555.

130. TEX. TAX CODE ANN. § 201.052(a) (Vernon 1982).

131. *Id.*

132. *Id.* § 201.101.

133. *Calvert v. Union Producing Co.*, 402 S.W.2d 221 (Tex. Civ. App.—Austin 1966, writ ref'd n.r.e.).

134. 794 S.W.2d at 556.

135. *Id.* (citing *Mobil Oil Co. v. Calvert*, 451 S.W.2d 889, 892 (Tex. 1970)).

136. 34 TEX. ADMIN. CODE § 5.15 (West 1988).

137. 794 S.W.2d at 556-57.

138. *Id.* at 557.

139. *Id.*

140. *Id.*

141. *Id.*

142. *Id.*

143. 788 S.W.2d 878 (Tex. App.—Corpus Christi 1990, writ granted).

thority under the Mineral Interest Pooling Act (MIPA)<sup>144</sup> does not authorize the pooling of separate reservoirs which are not in natural communication with each other even though the Commission may have previously granted a Rule 10<sup>145</sup> exception permitting downhole commingling of the hydrocarbons contained in those reservoirs.<sup>146</sup> Pend Oreille owned a working interest in a producing gas well situated in the Limes Field in Live Oak County, Texas. Bill Forney was the lessee of the land immediately adjacent to Pend Oreille's lease. The Limes Field consisted of two separate reservoirs: the main sand and a stray sand. The two sands were not in natural communication and constituted two separate reservoirs. The stray sand lay directly above the main sand and covered only a portion of the field. It was much thinner than the main sand, and the two were separated by six to ten feet of impermeable rock.

Pend Oreille operated a well on its lease which, pursuant to a Rule 10 exception granted by the Commission, commingled gas from both sands. Forney filed an application with the Railroad Commission to force pool his lease with Pend Oreille's. The Commission granted the application and, in the process, force pooled both the main sand and the stray sand. Pend Oreille sought review of the Commission's order by filing suit in Live Oak County. The trial court affirmed the Commission's order, but the court of appeals reversed, holding that the Commission had no statutory authority to enter the order.<sup>147</sup>

In holding that the Commission had exceeded its statutory authority, the court of appeals noted that the Commission was without statutory authority under the MIPA to pool more than "a common reservoir."<sup>148</sup> The appellees claimed, however, that because the Commission had granted a Rule 10 exception allowing both reservoirs involved to be produced as one, the reservoirs effectively became "a common reservoir" within the meaning of the MIPA. The court rejected this contention, reasoning that a Rule 10 exception provides only that commingled production of gas permitted under such an exception may be considered production from a common source of supply for the purposes of proration and allocation and not for the purpose of exercising the Commission's pooling authority under the MIPA.<sup>149</sup> In reaching this conclusion, the court analyzed the legislative history of Rule 10 and the evolution of the Commission's authority to grant exceptions from the "no commingling" provisions of that Rule.<sup>150</sup>

As matters stood in 1977, Rule 10 totally prohibited downhole commingling. Following decisions<sup>151</sup> of the Texas Supreme Court in 1977 and 1979

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144. TEX. NAT. RES. CODE ANN. § 102.001-.112 (Vernon 1978).

145. Tex. R.R. Comm'n, 16 TEX. ADMIN. CODE § 3.10 (West 1988).

146. 788 S.W.2d at 883.

147. *Id.* at 880.

148. *Id.* at 880-81 (citing TEX. NAT. RES. CODE ANN. § 102.011 (Vernon 1978)).

149. *Id.* at 883.

150. *Id.*

151. See *Railroad Comm'n of Texas v. Grayford Oil Corp.*, 557 S.W.2d 946 (Tex. 1977); *Gage v. Railroad Comm'n of Texas*, 582 S.W.2d 410 (Tex. 1979).

confirming the Commission's lack of authority to combine several reservoirs into a single field for administrative purposes, the Texas legislature amended the Natural Resources Code to grant the Commission authority to issue exceptions to Rule 10, thus allowing downhole commingling.<sup>152</sup> After the passage of this legislation, the Commission amended Rule 10 to permit exceptions from the Rule, but in the process further amended Rule 10 to provide that commingled production could be considered production from a common source of supply for purposes of proration and allocation.<sup>153</sup> Subsequently, the court of appeals held that the latter amendment of Rule 10 by the Commission was invalid. The court reasoned that although the legislature had given the Commission the authority to grant exceptions to Rule 10, it had not granted the Commission the authority to amend the Rule to allow commingled production to be considered production from a common source of supply for proration purposes.<sup>154</sup> In response to this judicial decision, the legislature granted the Commission the authority to prorate the production from commingled reservoirs as if they were from a common source of supply.<sup>155</sup>

The court of appeals in *Pend Oreille* concluded that this legislative history demonstrated a refusal by the legislature to grant the Commission broad general powers to regulate commingled oil and gas.<sup>156</sup> In the absence of any legislative history indicating an intent to expand the Commission's authority to pool under the MIPA, the court held that it was not reasonable to conclude that the legislature intended to give the Commission broader power than that which is expressly stated in the MIPA.<sup>157</sup> Because the MIPA is the sole source of the Commission's pooling authority and is clearly limited to tracts underlaid by "a common reservoir," the court was constrained to hold that the granting of a Rule 10 commingling exception did not alter the Commission's authority to pool.<sup>158</sup> Therefore, by the plain limitations of the MIPA, the Commission had no authority to enter an order pooling both the stray sand and the main sand as a common reservoir.<sup>159</sup>

In *Edwin M. Jones Oil Co. v. Pend Oreille Oil & Gas Co.*<sup>160</sup> a mineral owner sought a declaratory judgment that it owned a working interest share in a certain gas unit and sought recovery for its claimed share of production from such unit.

Edwin M. Jones Oil Company (Jones) owned the minerals in a certain eighty-acre tract of land at the time it entered into a farmout agreement with Pend Oreille. Under the provisions of the agreement, Pend Oreille agreed to drill a test well on or offsetting the Jones tract. If the well was commercially

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152. TEX. NAT. RES. CODE ANN. §§ 85.046, 86.012 (Vernon 1978 & Supp. 1991).

153. *Id.*

154. *See* Railroad Comm'n of Texas v. Mote Resources, 645 S.W.2d 639 (Tex. App.—Austin 1983, no writ).

155. TEX. NAT. RES. CODE ANN. §§ 85.053, -.055(d), 86.081 (Vernon 1978 & Supp. 1991).

156. 788 S.W.2d at 882.

157. *Id.* at 883.

158. *Id.*

159. *Id.*

160. 794 S.W.2d 442 (Tex. App.—Corpus Christi 1990, no writ).

productive, Jones agreed to lease the tract to Pend Oreille, reserving a 1/8th royalty and a 1/8th overriding royalty interest, and Pend Oreille agreed to form a gas unit which would include all of the Jones tract in accordance with the lease's pooling provisions. The farmout agreement further provided that Jones had the option to convert the 1/8th overriding royalty interest into a 1/3rd working interest in the well and the acreage allocated to the well. Thereafter, Jones could participate in the production allocated to the 1/3rd working interest attributable to the Jones tract on a surface-acreage basis.

Pend Oreille earned a lease on the Jones tract by drilling and completing a producing gas well, known as the Peet Well. In accordance with the farmout agreement, Jones leased the land to Pend Oreille who formed the 320-acre Peet Gas Unit, which included the entire Jones tract. Following payout, Jones converted its overriding royalty interest into a 1/3rd working interest in the well and the farmout acreage allocated to the well. The Peet Well then ceased production.

Pend Oreille drilled the Geffert No. 1 Well as a replacement well. This well was not located on the Jones tract, but it was within the Peet Gas Unit boundaries. Thereafter, Pend Oreille formed the 352-acre Geffert Gas Unit, which included the Jones tract, and dissolved the Peet Gas Unit. The Geffert No. 1 Well then ceased production and Pend Oreille drilled the Geffert No. 2 Well, which was situated within the Geffert Gas Unit, but on a tract which had not been included in the Peet Gas Unit.

Based on these facts, Jones contended that it had a working interest in both Geffert wells while Pend Oreille, on the other hand, claimed that Jones did not own a working interest in either well. The jury found that Jones had a working interest in the Geffert No. 1 Well, but that it had no working interest in the Geffert No. 2 Well.<sup>161</sup> Both parties appealed.

As to the Geffert No. 1 Well, the appellate court held that the evidence supported the jury finding that Jones owned a working interest in the well.<sup>162</sup> According to the court, under the farmout agreement, Jones was entitled to participate in unit production to the extent of 1/3rd of the production attributable to the lease on a surface-acreage basis.<sup>163</sup> The Geffert No. 1 Well was drilled on a tract within the Peet Gas Unit prior to the dissolution of the Peet Gas Unit, but after the time that Jones converted its overriding royalty interest into a working interest. Accordingly, Jones was entitled to a working interest in such well.<sup>164</sup>

As to the Geffert No. 2 Well, the appellate court held that Jones had no right to a working interest share.<sup>165</sup> The court noted that the well was not drilled on acreage which had been pooled with the farmout acreage and Jones had not executed the document designating the Geffert Gas Unit.<sup>166</sup>

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161. *Id.* at 445.

162. *Id.* at 449.

163. *Id.*

164. *Id.*

165. *Id.* at 448.

166. *Id.* at 447.

Thus, Jones had no pooled interest in the well.<sup>167</sup> Moreover, the court found significant the fact that the well had been drilled after Jones converted its overriding royalty interest into a working interest.<sup>168</sup> Because the farmout agreement and the lease only authorized Pend Oreille to pool Jones' royalty interest, the court ruled that Jones' working interest was never pooled.<sup>169</sup> The court further held that the lack of express pooling authority with respect to the interest at issue also precluded any conclusion that Jones owned a pooled interest in the well.<sup>170</sup> Therefore, the court concluded that Jones had no working interest in the No. 2 Well.<sup>171</sup>

The plaintiff in *Fletcher v. Ricks Exploration*<sup>172</sup> owned an oil, gas and mineral lease covering an undivided one-quarter interest in a certain 100-acre tract. Ricks Exploration Company and S. J. & R. Corporation owned an oil, gas and mineral lease covering an undivided one-half mineral interest in a thirty-acre tract which comprised part of the 100-acre tract. Ricks Exploration was also the operator of a producing gas unit encompassing the thirty-acre tract.

Ricks Exploration and others executed a unit designation pooling the thirty-acre tract with other acreage. Fletcher then executed and filed a ratification of the unit, seeking to share in the production from the unit gas well, despite the fact that the Texas Railroad Commission had determined that the thirty-acre tract was not productive as to gas and other products produced from the unit well. Ricks Exploration and S. J. & R. refused to account to Fletcher for any of the production from the well allocated to the thirty-acre tract. Thereafter, Fletcher filed suit claiming that he was entitled to share in unit revenues because his ratification of the unit designation had the effect of making him a unit participant just as if he had executed the unit designation instrument.

The trial court denied Fletcher's claim and the Fifth Circuit affirmed.<sup>173</sup> In reaching its decision, the Fifth Circuit reasoned that the unit designation did not constitute an offer to other interest owners within the unit to ratify the designation and participate in the unit because the instrument did not contain reasonably definite terms sufficient to qualify as an offer to pool.<sup>174</sup> Because the mere preparation and filing of a unit designation does not constitute an offer to all persons who hold leases on lands within the designated acreage to join in the unit, the court held that Fletcher could not accept an offer that was not extended to him by filing a ratification.<sup>175</sup>

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167. *Id.*

168. *Id.*

169. *Id.*

170. *Id.*

171. *Id.*

172. 905 F.2d 890 (5th Cir. 1990).

173. *Id.* at 892.

174. *Id.*

175. *Id.* at 892-93.

## V. MISCELLANEOUS ISSUES

A. *Gas Rights versus Oil Rights*

In the ongoing white oil controversy, the Texas Supreme Court in *Amarillo Oil Co. v. Energy-Agri Products, Inc.*<sup>176</sup> defined the meaning of "casinghead gas" as gas produced from an oil stratum and then analyzed whether the gas at issue fit that definition.<sup>177</sup>

Amarillo Oil owned the gas rights under a certain lease in Carson County, Texas. Energy-Agri owned the oil and casinghead gas rights under the same lease. In 1952, Amarillo Oil's predecessors in interest drilled and completed a producing gas well on the tract in the Brown Dolomite Formation which continued to produce gas. In 1982, Energy-Agri drilled and completed an oil well on the tract in the Granite Wash Formation. This well produced very small amounts of black crude oil and casinghead gas and almost no natural gas. Energy-Agri later perforated the casing in its oil well opposite the Brown Dolomite Formation and began producing approximately 375,000 cubic feet of gas per day from the formation. Amarillo Oil brought suit against Energy-Agri seeking to enjoin Energy-Agri from producing gas from the Brown Dolomite Formation, to quiet title to all of the gas in the formation, and to recover damages for the conversion of gas produced by Energy-Agri from the formation. The trial court rendered a take-nothing judgment for Amarillo Oil based on the jury verdict, which involved classification of the relevant wells.<sup>178</sup> Issues relating to title to the gas were not presented to the jury. On appeal by Amarillo Oil, the appellate court dismissed the case, holding that the action constituted an impermissible collateral attack on matters within the exclusive jurisdiction of the Texas Railroad Commission.<sup>179</sup>

The supreme court reversed, holding that the dispute between the parties involved the determination of ownership of the "casinghead gas."<sup>180</sup> Energy-Agri contended that the term "casinghead gas" means any gas produced from a well that has been classified by the Railroad Commission as an oil well and claimed that it was entitled to all gas produced by its oil wells. Amarillo Oil asserted that the statutory definition of "casinghead gas" controlled and that the determination of title to gas based upon the classification of a well by the Railroad Commission was inconsistent with such a definition.

The Texas Natural Resources Code defines "casinghead gas" as "any gas or vapor indigenous to an oil stratum and produced from the stratum with oil."<sup>181</sup> In order to apply this definition to the instant case, the supreme court examined the meaning of the term "oil stratum."<sup>182</sup> Although the

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176. 794 S.W.2d 20 (Tex. 1990).

177. *Id.* at 22-25.

178. *Id.* at 21.

179. 731 S.W.2d 113 (Tex. App.—Amarillo 1987), *rev'd*, 794 S.W.2d 20 (Tex. 1990).

180. 794 S.W.2d at 22.

181. TEX. NAT. RES. CODE ANN. § 86.002(10) (Vernon 1978).

182. 794 S.W.2d at 22-23.

Texas Natural Resources Code does not define the term "oil stratum," it does define an "oil well" as "any well that produces one barrel or more of oil to each 100,000 cubic feet of gas."<sup>183</sup> The court thus reasoned that an "oil stratum" was a stratum that produces 100,000 cubic feet of gas or less per barrel of oil.<sup>184</sup> Additionally, the court noted that the statutory definition of "casinghead gas" requires that such gas must be produced as a necessary incident to the production of oil.<sup>185</sup>

To determine whether Energy-Agri was producing gas or "casinghead gas" from its oil wells, the court examined each of Energy-Agri's completions in the Brown Dolomite Formation and determined whether the production from that stratum at that particular location yielded a producing gas/oil ratio of 100,000 cubic feet of gas or less per barrel of oil.<sup>186</sup> The supreme court rendered judgment quieting Amarillo Oil's title to gas, other than casinghead gas, as defined in the opinion, produced from the Brown Dolomite Formation through Energy-Agri's oil wells.<sup>187</sup>

The supreme court rejected Energy-Agri's claims that the court had no jurisdiction over the case because it involved the classification of oil and gas wells, a matter within the exclusive jurisdiction of the Texas Railroad Commission.<sup>188</sup> In this respect, the court held that the dispute between the parties was over the ownership of the gas being produced from the Brown Dolomite Formation,<sup>189</sup> and therefore, the cause was properly within the jurisdiction of the courts since the Texas Railroad Commission has no authority to determine title to land or property rights.<sup>190</sup> The court did respect the Railroad Commission's express approval of Energy-Agri's production of gas from the Brown Dolomite Formation,<sup>191</sup> however, noting that such authorization does not mean that Energy-Agri owned the gas.<sup>192</sup> Because of the Commission approval, the supreme court held the injunctive relief improper as a remedy for Amarillo Oil's legal damage.<sup>193</sup> The supreme court was unable to assess damages due to the state of the record and remanded the cause to the trial court for determination of damages.<sup>194</sup>

### B. Joint Operations

In *Vortt Exploration Co. v. Chevron U.S.A., Inc.*<sup>195</sup> the Texas Supreme Court held that the elements of *quantum meruit* were met in connection with a claim for the value of seismic information provided in the course of

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183. TEX. NAT. RES. CODE ANN. § 86.002(6) (Vernon 1978).

184. 794 S.W.2d at 22.

185. *Id.* at 25.

186. *Id.*

187. *Id.*

188. *Id.* at 25-26.

189. *Id.*

190. *Id.* at 26.

191. *Id.* at 27.

192. *Id.*

193. *Id.*

194. *Id.* at 28.

195. 787 S.W.2d 942 (Tex. 1990).



unsuccessful negotiations for a joint operating agreement.<sup>196</sup> Chevron and Vortt owned mineral interests in different portions of a tract of land. In 1978, Vortt contacted Chevron seeking a farmout agreement regarding Chevron's portion of the tract. Chevron rejected this request so Vortt proposed that the two companies enter into a joint operating agreement. Chevron informed Vortt that it might be interested in such an arrangement and requested that Vortt submit a proposal. Chevron and Vortt negotiated for several years regarding the specifics of such an arrangement without ever reaching an agreement. During the negotiations, Vortt provided Chevron with confidential seismic services, graphics, and maps in an attempt to reach a joint operating agreement. After negotiations were broken off, Chevron drilled a producing well at the location identified in the information provided by Vortt.

Chevron brought suit to invalidate certain leases held by Vortt. Vortt counterclaimed, asserting the validity of its leases, or alternatively, claiming entitlement to recovery under *quantum meruit* for the seismic services provided to Chevron. The trial court rendered judgment in favor of Vortt on its *quantum meruit* claim.<sup>197</sup> The court of appeals reversed, however, and rendered in favor of Chevron on the basis that Vortt failed to establish one of the elements for recovery under *quantum meruit*.<sup>198</sup> Specifically, the court of appeals held that there was not a factual finding that Vortt furnished the seismic information under such circumstances as to "reasonably notify Chevron that Vortt expected payment<sup>199</sup> for the services and assistance which were provided."<sup>200</sup>

The supreme court disagreed.<sup>201</sup> To recover under *quantum meruit*, a plaintiff must prove the following elements: 1) valuable services were rendered or materials were furnished; 2) for the person sought to be charged; 3) which services and materials were accepted by the person sought to be charged, and used or enjoyed by him; and 4) under such circumstances as reasonably notified the person sought to be charged that the plaintiff, in performing such services or furnishing such material, was expecting to be paid by the person sought to be charged.<sup>202</sup> The relevant findings of fact by the trial court included the following:

- (9) Vortt provided the [seismic] services and assistance to Chevron in the belief that Chevron and Vortt would jointly develop the subject 160 acres for the production of oil and gas, but for such belief would not have provided such services and assistance to Chevron, which were undertaken for both Chevron and Vortt.<sup>203</sup>

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196. *Id.* at 945.

197. *Id.* at 944.

198. 787 S.W.2d 414, 417 (Tex. App.—Fort Worth 1988), *rev'd*, 787 S.W.2d 942 (Tex. 1990).

199. 787 S.W.2d at 417.

200. *Id.* at 416-17.

201. 787 S.W.2d at 945.

202. *Id.* at 944 (citing *Bashara v. Baptist Memorial Hosp. Sys.*, 685 S.W.2d 307, 310 (Tex. 1985)).

203. 787 S.W.2d at 416.

13. Chevron was reasonably notified that Vortt in performing such services and assistance for Chevron expected to join with Chevron in a mutually satisfactory agreement for their joint production of oil and gas from the subject 160 acres.<sup>204</sup>

The court of appeals stated that such notification did not rise to the level of that required by the fourth element of a quantum meruit claim because such services were not rendered under circumstances that would reasonably notify Chevron that Vortt expected to be paid for the seismic information.<sup>205</sup> The supreme court, however, held that the expected payment did not have to be monetary, but could be any form of compensation.<sup>206</sup> Since Chevron knew that Vortt furnished the information with the expectation that a joint operating agreement would be reached, the supreme court held that the trial court's finding of fact reflected that Chevron was reasonably notified that Vortt expected to be paid for the services and assistance that were rendered.<sup>207</sup> Accordingly, the supreme court reversed the judgment of the court of appeals and remanded the cause to that court to consider several other points of error on which the court of appeals did not originally rule.<sup>208</sup>

In *C & C Partners v. Sun Exploration & Production Co.*<sup>209</sup> the Dallas court of appeals held that the Texas Deceptive Trade Practices Act<sup>210</sup> (DTPA) did not apply to oil and gas operations conducted under exploration and joint operating agreements because the claimant nonoperator was not a consumer within the meaning of the statute.<sup>211</sup> Sun filed a lawsuit against C & C and others, asserting claims for breach of exploration and joint operating agreements and for fraudulent misrepresentation in connection with operations thereunder. C & C counterclaimed against Sun, alleging certain violations of the DTPA. Following trial, the district court granted an instructed verdict for Sun on C & C's DTPA counterclaim on the ground that C & C and the other defendants were not "consumers" as defined by the DTPA.<sup>212</sup> In accordance with the jury's findings, the trial court rendered judgment in favor of Sun for breach of contract and fraudulent misrepresentation and awarded actual and punitive damages, prejudgment

204. *Id.*

205. 787 S.W.2d 414, 417 (Tex. App.—Fort Worth 1988), *rev'd*, 787 S.W.2d 942 (Tex. 1990).

206. 787 S.W.2d 942, 945 (Tex. 1990).

207. *Id.*

208. *Id.*

209. 783 S.W.2d 707 (Tex. App.—Dallas 1989, writ denied).

210. TEX. BUS. & COM. CODE ANN. §§ 17.41-.63 (Vernon 1987).

211. 783 S.W.2d 712-13.

212. *Id.* As the appellate court noted:

One who maintains a private lawsuit under § 17.50 of the DTPA (providing a private right of action for consumers) must be a consumer as defined in § 17.45(4). *Riverside Nat'l Bank v. Lewis*, 603 S.W.2d 169, 173 (Tex. 1980); . . . . Under the DTPA, a consumer is defined, in pertinent part, as "an individual, partnership, [or] corporation. . . who seeks or acquires by purchase or lease, any goods or services. TEX. BUS. & COM. CODE ANN. § 17.45(4) (Vernon 1987)."

783 S.W.2d at 711-12.

interest, and attorneys' fees.<sup>213</sup>

C & C appealed on a number of grounds, one of which related to the trial court's granting of an instructed verdict on the DTPA counterclaim. C & C asserted that certain fact issues existed surrounding its status as a consumer and that Sun failed to establish as a matter of law that C & C and the other defendants were not consumers. C & C contended that it purchased services and materials from Sun, and therefore, it was a consumer.

To establish its status as a consumer under the DTPA, a plaintiff must first show that it sought or acquired goods or services by purchase or lease; and second, that the goods or services purchased or leased form the basis of the complaint under the DTPA.<sup>214</sup> In the case at hand, Sun was the operator and C & C and the other defendants were the nonoperators with respect to three properties covered by separate joint operating agreements. The agreements provided that the joint account would be charged for items such as the labor costs of Sun's field employees, the materials purchased or furnished for use on the prospect properties, and the costs of services provided by contract personnel on the prospect properties. The parties' joint account was charged for these labor costs, materials, and services. Additionally, C & C was billed for its share of administrative costs incurred by Sun on behalf of all of the parties. Sun sought reimbursement only for costs incurred on behalf of the operating and nonoperating interest owners and did not make a profit when it charged for these costs. Following the factually similar case of *Hamilton v. Texas Oil & Gas Corp.*,<sup>215</sup> the appellate court held that C & C was not a consumer under the DTPA as a matter of law.<sup>216</sup>

The other issue relevant to oil, gas and mineral law discussed on appeal concerned the effect of the absence of written authorizations for expenditures (AFE). C & C claimed that the nonoperating interest owners did not consent to the operations for which Sun sought recovery of the nonoperators' share of costs. C & C argued that under the requirements of the operating agreements, the nonoperators' consent had to be evidenced in writing by means of AFEs and no written consent in the form of AFEs had been signed by C & C. The appellate court rejected this claim, however, noting that the joint operating agreements did not require consent to be in any particular form.<sup>217</sup>

On the basis of other points of error not discussed here, the appellate

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213. *Id.* at 711.

214. *Id.* at 712 (citing *Melody Home Mfg. Co. v. Barnes*, 741 S.W.2d 349, 351-52 (Tex. 1987)).

215. 648 S.W.2d 316 (Tex. App.—El Paso 1982, no writ).

216. 783 S.W.2d at 713.

217. The court stated:

The contracts clearly require consent, but they do not specify that any particular form of consent is required. Consent by telephone is permitted but not required under certain circumstances. Any telephoned notice or response (consent or nonconsent) is required to be confirmed in writing. Thus, the only requirement of a writing is in the case of *confirmation of consent or nonconsent* or confirmation of notice of a proposed operation. Confirmation of consent is obviously distinct and separate from consent itself, as to which there is no requirement of a writing. Moreover, the contract plainly does not state that consent is invalid or

court reversed the trial court's award of actual and punitive damages in connection with Sun's fraudulent misrepresentation claim and rendered a take-nothing judgment for Sun.<sup>218</sup> Additionally, the court of appeals reversed the trial court's award of prejudgment interest and remanded the case for further proceedings on this issue.<sup>219</sup> The appellate court affirmed the judgment of the trial below in all other respects.<sup>220</sup>

### C. Other Issues

In *Winslow v. Acker*<sup>221</sup> the San Antonio court of appeals held that the executive right holder did not breach her obligations to the nonexecutive interest owners by obtaining an overriding royalty for herself under an oil and gas lease covering the property at issue because the executive had strictly complied with the express terms of the grant of the executive right by reserving a proportionate share of a 1/8th royalty for the nonexecutives.<sup>222</sup> This case arose out of a partition deed which severed the executive right from a portion of the mineral estate. Following the death of J.E. Murphy, his five children partitioned the land that they inherited from their father by executing individual partition deeds. The deed at issue in the lawsuit conveyed certain property to Johnie Lorene Acker from her brother and sisters and contained a reservation relating to the executive right.<sup>223</sup> Subsequently, Johnie Lorene Acker executed four separate oil and gas leases to the same lessee, each lease relating to a portion of the lands covered by the partition

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ineffective if it is not confirmed in writing. The provisions on consent also contain absolutely nothing about AFEs.

*Id.* at 714-15 (emphasis in original).

218. *Id.* at 718-20, 724.

219. *Id.* at 720-21, 724.

220. *Id.* at 784.

221. 781 S.W.2d 322 (Tex. App.—San Antonio 1989, writ denied).

222. *Id.* at 328.

223. The deed provided, in part:

Provided, however, it is expressly understood and agreed by each and all of the parties hereto that no part of the oil, gas, or other minerals in, on, or under the above-described lands are hereby conveyed or are intended or affected by this instrument except as hereinafter provided, and the parties hereto, their respective heirs and assigns, shall continue to own and hold in common all of the oil, gas and other minerals, in, on, and under all of the above-described lands in the same undivided proportion that said parties now own and hold said oil, gas and other minerals . . . , and none of the royalties, reversionary interests, or other rights of said parties under existing oil, gas and mineral leases shall be affected in any manner by this instrument; it being further provided, however, anything in the foregoing to the contrary notwithstanding, that the grantee of the surface estate herein, Johnie Lorene Acker, shall have the exclusive right to execute, without the joinder of any of the grantors herein, any oil, gas or mineral lease that she desires on any such terms as she may desire, and receive, as her separate property, such bonuses, oil payments, and rentals as may be paid under said oil, gas and mineral leases so executed by her, except that she shall reserve in each oil, gas, and mineral lease so executed by her a base one-eighth (1/8) royalty interest for the benefit of herself and the other four children of J.E. Murphy, deceased, grantors herein, in the same proportion they now own same.

*Id.* at 324.

deed to Acker. The lessee under the leases assigned a 5-1/2% overriding royalty interest to Johnie Lorene Acker and her husband.

The nonexecutive owners of the pertinent tracts brought suit against Acker and her husband, claiming entitlement to a portion of the overriding royalty interest. The nonexecutives also sought damages for breach of fiduciary duty and conspiracy by Acker in obtaining the overriding royalties. The Ackers counterclaimed seeking a declaration of their right to retain the overriding royalties. The trial court granted the Acker's motion for summary judgment and declared that the nonexecutives had no right, title or interest in the overriding royalty interest.<sup>224</sup> The judgment also decreed that the nonexecutives had reserved unto themselves, their heirs and assigns, an undivided 4/5ths of 1/8th royalty and granted to Johnie Lorene Acker the executive rights and the right to receive all other benefits derived from leasing the mineral estate, including overriding royalties and royalties over and above 4/5ths of 1/8th.<sup>225</sup>

On appeal, the nonexecutives claimed that the granting of the motion for summary judgment was improper. The nonexecutives asserted that a question of fact existed regarding the ambiguous term "base one-eighth royalty" contained in the partition deed. They claimed that the deed was unclear as to whether they were entitled to a set fraction of production or a fraction of subsequent royalties to be determined by the terms of future leases. The nonexecutives sought to share in 4/5ths of whatever royalties Acker contracted for. The appellate court found that the deed was not ambiguous and that the deed reserved for the nonexecutives a set fraction of production, being 4/5ths of 1/8th of production.<sup>226</sup>

By a second point of error, the nonexecutives claimed that the trial court erred in considering the overriding royalty interest to be bonus payments rather than royalties. The appellate court held that questions regarding the classification of royalty and mineral interest, however, were immaterial to the instant case.<sup>227</sup> Under the partition deed, the nonexecutives parted with any right to participate in bonuses, rentals, oil payments and production over and above an undivided 4/5ths of a base 1/8th royalty, thus classification of the interest in question was irrelevant.<sup>228</sup>

Finally, the nonexecutives asserted that Acker breached her duty of utmost good faith and fair dealing by obtaining overriding royalties to the exclusion of the nonexecutives. In response, the appellate court noted that there could be no breach of duty by an executive who receives an overriding royalty interest where the nonexecutives are entitled to participate only in a fraction of the production from the property.<sup>229</sup> Likewise, there could be no conspiracy to deprive the nonexecutives of an interest to which they were

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224. *Id.* at 323.

225. *Id.*

226. *Id.* at 327.

227. *Id.*

228. *Id.*

229. *Id.* at 328.

not entitled.<sup>230</sup> Accordingly, the court of appeals affirmed the judgment of the trial court.<sup>231</sup>

In *Northern Natural Gas Co. v. Vanderburg*<sup>232</sup> the court of appeals construed portions of the Texas Natural Resources Code in determining that a pipeline purchaser had unlawfully withheld payment of the proceeds of gas production allocable to a royalty interest.<sup>233</sup> In this case, the undisputed evidence demonstrated that Vanderburg owned the royalty interest under a 1938 oil, gas and mineral lease. Damson claimed title to the gas rights under the lease and Vanderburg Exploration, Inc. (VEI) claimed title to the oil and casinghead gas rights under the lease. There were two purported oil wells and one dry gas well located on the tract. Northern purchased the casinghead gas under written contract covering the two oil wells operated by VEI and remitted all payments to VEI. Damson and VEI were involved in litigation concerning ownership of the gas produced by VEI from the tract and delivered to Northern under the VEI-Northern contract. Pending resolution of the title dispute between Damson and VEI, Northern suspended payment of all proceeds from its purchase of the gas production. Vanderburg requested Northern to make payments of his royalty interest directly to him because title to his royalty interest was not at issue in the dispute between Damson and VEI. Northern refused and suit followed.

Among other theories, Vanderburg asserted a cause of action under the provisions of the Texas Natural Resources Code.<sup>234</sup> This statute provides a mineral interest owner with a cause of action against a payor for the non-payment of oil or gas proceeds, plus interest and attorneys' fees.<sup>235</sup> It was undisputed that Northern was the purchaser of the gas production from the wells at issue, and therefore, qualified as a payor within the meaning of the statute.<sup>236</sup> Northern claimed, however, that under the statute, the producer, rather than the purchaser, is deemed to be the payor if the proceeds derived from the sale of production have been paid by the purchaser to the producer and the latter assumes the responsibility of paying those proceeds to the various mineral interest owners. Northern further claimed that such an arrangement had been made between it and VEI in this case. The court of appeals rejected Northern's claim.<sup>237</sup> The court reasoned that for the exception to apply there must be: 1) a contract between the producer and the purchaser;

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230. *Id.*

231. *Id.*

232. 785 S.W.2d 415 (Tex. App.—Amarillo 1990, no writ).

233. *Id.* at 419.

234. TEX. NAT. RES. CODE ANN. §§ 91.401-.406 (Vernon Supp. 1991).

235. *Id.* § 91.404(c).

236. Payor is defined in the statute as:

the first purchaser of production of oil or gas from an oil or gas well, but the owner of the right to produce under an oil or gas lease or pooling order is deemed to be a payor if the owner of the right to produce and the first purchaser have entered into arrangements providing that the proceeds derived from the sale of oil or gas have been paid by the first purchaser to the owner who assumes the responsibility of paying those proceeds to the payee.

TEX. NAT. RES. CODE ANN. § 91.401(2) (Vernon Supp. 1991).

237. 785 S.W.2d at 419.

2) payment of the proceeds derived from the sale of production by the purchaser to the producer; and 3) the assumption by the producer of the responsibility to pay the proceeds to the payee.<sup>238</sup> Even assuming that the first and third elements of the exception were satisfied, the court found that the evidence established that Northern did not satisfy the second element because, as the purchaser of production, it had not paid the proceeds from the sale of the gas at issue to the producer, VEI.<sup>239</sup> As a result, Northern was the payor under the statutory definition and was not entitled to the benefits of the exception.<sup>240</sup>

Northern further contended that it should not be held liable because it had not unreasonably delayed payment in violation of section 11.089(b) of the Texas Natural Resources Code<sup>241</sup> since the contract between Northern and VEI authorized Northern to withhold proceeds from the sale of gas in the event of a title dispute. The court of appeals made short work of this contention, reasoning that Vanderburg was not bound by the provisions of the Northern-VEI contract because he was neither a party to nor a third-party beneficiary of the contract.<sup>242</sup> Further, Vanderburg's title was not in dispute, and therefore, the statutory provision which Northern sought to assert was not applicable.<sup>243</sup> Finally, the court observed that Northern had delayed Vanderburg's royalty payments for four years, which was well beyond the sixty-day and ninety-day grace periods provided by the statute<sup>244</sup> for delaying such payments.<sup>245</sup> Under these circumstances, the court concluded that the delay was unreasonable.<sup>246</sup>

The issues involved in *Hunt v. HNG Oil Co.*<sup>247</sup> arose out of claims of a mineral trespass. The Hunts, as lessors, sued their lessee, HNG, for trespass and conversion. While an oil and gas lease between the Hunts and HNG remained in effect, HNG drilled a well on the Hunts' lands. In February 1986, the well was determined to be a dry hole at total depth, thus HNG plugged back the well to a lesser depth pending a completion attempt in a shallower zone. The well was ultimately completed in September 1986 as a producing gas well. It produced gas until July 1987, when it was plugged and abandoned.

The Hunts claimed that HNG wrongfully entered onto their land and converted their natural gas when HNG completed the well at the shallower

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238. *Id.*

239. *Id.*

240. *Id.*

241. "No common purchaser may unreasonably delay payments to a royalty owner or landowner or both in purchases of . . . oil or gas." TEX. NAT. RES. CODE ANN. § 111.089(b) (Vernon 1978).

242. 785 S.W.2d at 419.

243. *Id.*

244. The Texas Natural Resources Code requires payment of proceeds to be made no later than sixty days and ninety days for oil and gas, respectively, following the end of the calendar month in which such production is sold. See TEX. NAT. RES. CODE ANN. § 91.402(a) (Vernon Supp. 1991).

245. 785 S.W.2d at 419.

246. *Id.*

247. 791 S.W.2d 191 (Tex. App.—Corpus Christi 1990, writ denied).

depth. According to the Hunts, the oil and gas lease expired by its own terms sixty days after February 8, 1986, the date on which they claimed HNG ceased operations on the leased premises. Under this reasoning, HNG was a trespasser when it later completed the well, and thus HNG converted the Hunts' gas. Following trial, the jury answered all questions in favor of HNG and the court rendered judgment accordingly.<sup>248</sup> The Hunts appealed, contending that they were entitled to judgment as a matter of law. The Hunts did not, however, challenge the jury's finding of good faith on the part of HNG when it entered onto the Hunts' lands in September 1986.<sup>249</sup>

On appeal, HNG asserted that, even if all of the points of error urged by the Hunts were meritorious, the Hunts could not prevail because they suffered no damages as a matter of law. The appellate court agreed,<sup>250</sup> and thus did not address the issues of whether the lease had in fact expired and whether HNG was a good faith trespasser. Instead, the sole issue addressed by the court was the measure of damages for a defendant's good faith trespass and removal of minerals from a plaintiff's land.

In *Bender v. Brooks*,<sup>251</sup> the leading case in Texas on the measure of damages for a good faith oil and gas trespass, the Texas Supreme Court adopted the rule that a good faith trespasser is liable in damages only for the value of the minerals removed, less drilling and operating costs.<sup>252</sup> Under Texas law, the costs and expenses that may be deducted by the good faith trespasser in usual circumstances include drilling costs, completion costs, production taxes, transportation charges, operating expenses, and royalties paid to the lessors.<sup>253</sup>

This case, however, did not involve usual circumstances. HNG was not a trespasser when it drilled the well since the well was drilled under a valid lease.<sup>254</sup> The appellate court held that HNG was not entitled to reimbursement of the cost of the initial drilling of the well because it was not a trespasser at that time.<sup>255</sup> Nevertheless, the total of HNG's other costs and expenses for which it was entitled to reimbursement exceeded the revenues from the Hunts' lands.<sup>256</sup> Thus, the Hunts could show no harmful error since they suffered no damages.<sup>257</sup>

*Texas Gas Exploration Corporation v. Broughton Offshore Ltd. II*,<sup>258</sup> involved the breach of a long-term, offshore drilling contract. In 1981, Texas Gas, as operator, entered into such a contract with Broughton, as contrac-

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248. *Id.* at 192.

249. *Id.* at 193.

250. *Id.*

251. 103 Tex. 329, 127 S.W. 168 (1910).

252. *Id.*; 127 S.W. at 170-71.

253. See *Right of Way Oil Co. v. Gladys City Oil, Gas & Mfg. Co.*, 106 Tex. 94, 157 S.W. 737 (1913); *Bender v. Brooks*, 103 Tex. 329, 127 S.W. 168 (1910); *Mayfield v. de Benavides*, 693 S.W.2d 500 (Tex. App.—San Antonio 1985, writ ref'd n.r.e.); *Dahlstrom Corp. v. Martin*, 582 S.W.2d 159 (Tex. Civ. App.—Houston [1st Dist.] 1979, writ ref'd n.r.e.).

254. 791 S.W.2d at 194.

255. *Id.*

256. *Id.*

257. *Id.*

258. 790 S.W.2d 781 (Tex. App.—Houston [14th Dist.] 1990, no writ).



tor. The contract provided for an initial term of two years beginning March 10, 1981, to "continue thereafter for the time required to complete operations on any well then drilling."<sup>259</sup> On March 9, 1983, Broughton was engaged in drilling operations for Texas Gas under the contract. On that date, Texas Gas ordered Broughton to place a temporary cap on the well, shut down operations, and move off the location. Thereafter, Texas Gas contracted with another rig to complete drilling operations on the well at a lower daily rate.

Broughton brought suit against Texas Gas for breach of contract. Broughton asserted that, under the term provision of the contract, it was entitled to complete operations on the well. Texas Gas claimed that the contract expired on March 10, 1983, and would continue only if Texas Gas elected to have Broughton complete the required drilling on the well. The court of appeals affirmed the trial court's partial instructed verdict that Texas Gas breached the drilling contract as a matter of law.<sup>260</sup>

The court noted that if the parties to the contract had intended for Texas Gas to have the option on March 10, 1983, to determine whether Broughton would be permitted to complete the drilling of a well, they would have expressed such intent in the contract.<sup>261</sup> The term provision of the contract, however, was expressed in mandatory language.<sup>262</sup> To accept Texas Gas' interpretation of the contract would be to render such language meaningless.<sup>263</sup> According to the court, the contract was unambiguous: "if Texas Gas chose to continue operations on the well, it must [have] allowed Broughton to continue the work."<sup>264</sup> The evidence established that Texas Gas always intended to complete the drilling of the well.<sup>265</sup> Accordingly, the court held that Texas Gas breached the contract by ordering Broughton to demobilize and then completing the well with a different drilling contractor.<sup>266</sup>

*B & A Pipeline Co. v. Dorney*<sup>267</sup> arose out of a dispute under a farmout agreement and two gas purchase contracts. On May 10, 1982, Henderson Clay Products (HCP) entered into an agreement to sell gas to B & A Pipeline. This gas purchase contract provided that HCP would sell and deliver to B & A natural gas produced from leases that HCP then held or later acquired within a certain defined area. The contract required B & A to take or pay for 85% of the delivery capacity of the wells on the contract acreage. The next day, B & A entered into a gas contract with Lone Star Gas Company whereby B & A dedicated its marketable interest in gas produced from the same contract acreage covered by the May 10 contract. The May 11

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259. *Id.* at 784.

260. *Id.*

261. *Id.* at 785.

262. *Id.*

263. *Id.*

264. *Id.*

265. *Id.* at 786.

266. *Id.*

267. 904 F.2d 996 (5th Cir. 1990).

contract obligated Lone Star to take or pay for 85% of the delivery capability of the wells in the contract acreage.

Dorney held leases in the contract area covered by the gas purchase contracts. During the period that the gas contracts were being negotiated, Dorney and a representative of HCP entered into a tentative farmout agreement under which HCP would market the gas from Dorney's acreage. This agreement was finalized in November 1982. It provided, among other things, that Dorney had the right to share in a proportionate part of any payments made for gas not actually taken. Under the agreement, Dorney retained the right to take his gas in kind.

In 1985, B & A sued Lone Star for breach of the May 11 gas contract seeking recovery under the take-or-pay provision. Dorney intervened in the lawsuit claiming entitlement to his proportionate share of any take-or-pay payments. The parties to the lawsuit other than Dorney settled the dispute in 1988. Under the terms of the settlement, the gas contract was amended to require Lone Star to purchase greater quantities of gas at a price in excess of the then prevailing market price. No take-or-pay payments were made under the settlement agreement. Following the settlement, B & A and HCP amended the May 10 gas contract to include a dedication provision pertaining to specific wells, rather than the general acreage provisions under the original contract, and to delete B & A's take-or-pay obligation.

Dorney amended his petition in intervention, asserting claims against B & A for, among other things, breach of its obligations to Dorney under the May 11 contract and for fraud by falsely promising to prosecute its take-or-pay claims against Lone Star for Dorney's benefit. The district court granted summary judgment for the defendants, and the Fifth Circuit affirmed.<sup>268</sup>

As to Dorney's breach of contract claims, Dorney admitted that he was not a party to the contract between Lone Star and B & A. Nevertheless, he claimed that B & A was obligated to him under the contract because his gas was dedicated to Lone Star by B & A. The court, however, found that Dorney's gas was not dedicated under the contract as a matter of law.<sup>269</sup> "[W]hen a gas well owner reserves the right to take the production of the well in kind, the production of that well is not dedicated."<sup>270</sup>

The court found that Dorney's claim for fraud was likewise without merit.<sup>271</sup> Dorney failed to show that he relied on any promise by B & A that it would prosecute the take-or-pay claims against Lone Star for his benefit.<sup>272</sup> Indeed, the court noted that Dorney's intervention in the lawsuit illustrated that there was no such reliance.<sup>273</sup>

*Noble Exploration v. Nixon Drilling Co.*<sup>274</sup> involved an action against a

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268. *Id.* at 997.

269. *Id.* at 1000.

270. *Id.*

271. *Id.*

272. *Id.*

273. *Id.*

274. 794 S.W.2d 589 (Tex. App.—Austin 1990, no writ).

drilling company by the owner of the leasehold estate seeking a judicial declaration that the drilling company's lien affidavit was invalid and seeking removal of cloud on its title created by the lien affidavit. The trial court rendered a take-nothing judgment, and the leaseholder appealed.<sup>275</sup> The appellate court reversed, and rendered in part, and remanded in part.

Anthony Exploration Company, Noble's predecessor in interest, obtained an oil, gas and mineral lease on a certain 101-acre lease tract and entered into a farmout agreement with Nobleson Operating Company. Under the terms of the farmout agreement, Anthony agreed to assign the working interest under the lease to Nobleson (subject to a reservation of an overriding royalty interest) if Nobleson drilled and completed a commercially productive well on forty acres of the tract. Nobleson thereafter entered into a drilling contract with Nixon for the drilling of a well on the tract. Although Nixon drilled a well, the well was not completed as a commercial producer, and thus Nobleson failed to pay Nixon for its services. Nixon filed lien affidavits in the county records purporting to secure a lien as to the forty acres surrounding the well. Anthony then brought suit against Nixon. Prior to trial, Anthony assigned its interest in the lease to Noble and Noble was substituted as the real party plaintiff.

Noble appealed the granting of the take-nothing judgment, claiming that the evidence established as a matter of law that Nixon improperly secured a lien against Noble's leasehold estate because there was no contract between Nixon and Noble, or Noble's trustee, agent, or receiver.<sup>276</sup> Nixon claimed that Nobleson was Anthony's agent, and that there was an implied contract between Nixon and Anthony. These arguments were based on the existence of the farmout agreement between Anthony and Nobleson at the time Nobleson contracted with Nixon.

With regard to Nixon's claim of an implied contract, the court of appeals held that there could be no contract implied in fact between Nixon and Anthony because there was no mutual agreement between them.<sup>277</sup> There was no contract implied in law because there was no representation to Nixon that Nobleson was a mineral property owner.<sup>278</sup> Indeed, the court held that Nixon was charged with constructive notice of the information contained in the public records that Anthony was the mineral property owner.<sup>279</sup> Additionally, the court found that there could be no implied contract in light of the express contract between Nobleson and Nixon.<sup>280</sup>

As to Nixon's claim of agency between Anthony and Nobleson, the court

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275. *Id.* at 590.

276. The Texas Property Code provides that "[a] mineral contractor or subcontractor has a lien to secure payments for labor or services relating to mineral activities." TEX. PROP. CODE ANN. § 56.002 (Vernon 1984). The term mineral contractor is defined as "a person who performs labor or furnishes or hauls material, machinery, or supplies used in mineral activities under an express or implied contract with a mineral property owner or with a trustee, agent, or receiver of a mineral property owner." TEX. PROP. CODE ANN. § 56.001(2) (Vernon 1984).

277. 794 S.W.2d at 592.

278. *Id.*

279. *Id.*

280. *Id.*

of appeals found no evidence that Nobleson acted on behalf of Anthony or was subject to Anthony's control or that Anthony and Nobleson consented to such an arrangement.<sup>281</sup> Nor was there any evidence of conduct from which an agency arrangement could be implied.<sup>282</sup>

Having found no evidence that would support the implied findings of the trial court, the court of appeals found that the evidence established as a matter of law that Nixon was not a "mineral contractor" and was not entitled to a mineral lien under the applicable provisions of the Texas Property Code.<sup>283</sup> Accordingly, the court of appeals reversed the trial court's judgment, rendered judgment invalidating the lien and removing any cloud on Noble's title created by the filing of such lien, and remanded the case in part to the trial court for proceedings to determine damages and fees, if any, to which Noble was entitled.<sup>284</sup> *W & W Oil Co. v. Capps*<sup>285</sup> also involved a situation where a contractor was not paid for goods and services furnished to a farmee under a farmout agreement. In 1985, W & W and Sam Hooper, as owners of a certain leasehold estate, entered into a farmout agreement with Devonian Corporation. At Devonian's request, Capps furnished goods and performed services in connection with Devonian's operations on the lease. Capps had no knowledge of the farmout agreement. Devonian failed to pay Capps for the goods and services. Likewise, W & W was not paid by Devonian for the farmout agreement and thus W & W exercised its right under the agreement to terminate Devonian's interest and resume control of the lease. Capps brought suit against Devonian and W & W on a variety of causes of action. Devonian never answered the lawsuit or appeared in court. W & W claimed that it was not liable to Capps because Capps provided the goods and services solely for, and at the instance of, Devonian. Nevertheless, the trial court rendered judgment for Capps against W & W on the theory of quantum meruit.<sup>286</sup>

On appeal, W & W claimed that the trial court erred in granting judgment for Capps on the theory of quantum meruit because a valid, express contract existed. The court noted that, as a general rule, where there is a valid express contract covering the subject matter, there can be no implied contract.<sup>287</sup> This rule applies not only when the plaintiff is seeking to recover in quantum meruit from the party with whom he has expressly contracted, but also in a situation where the plaintiff is seeking to recover from a third party who benefitted from the performance, as in this case.<sup>288</sup> Since the evidence conclusively established the existence of an express contract between Devonian and Capps for the performance of services and payment therefore, the

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281. *Id.*

282. *Id.*

283. *Id.* at 593.

284. *Id.*

285. 784 S.W.2d 536 (Tex. App.—Tyler 1990, no writ).

286. *Id.* at 537.

287. *Id.* (citing *Woodard v. Southwest States, Inc.*, 384 S.W.2d 674 (Tex. 1964)).

288. *Id.* (citing *Black Lake Pipe Line Co. v. Union Const. Co.*, 538 S.W.2d 80 (Tex. 1976), *overr. on other grounds*, 767 S.W.2d 686 (Tex. 1989)).

court limited Capps to recovery on the express contract.<sup>289</sup> The appellate court therefore reversed the trial court's judgment against W & W based on quantum meruit.<sup>290</sup>

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289. *Id.*

290. *Id.* at 538.