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OIL, GAS, AND MINERAL LAW

Stuart C. Hollimon*
Robert E. Vinson, Jr.**

I. ISSUES INVOLVING CONVEYANCING

A. Two-Grant Theory

IN *Luckel v. White*¹ and *Jupiter Oil Co. v. Snow*² the Texas supreme court overruled its decision in *Alford v. Krum*³, and breathed new life into the so-called "two-grant" theory of conveyancing in Texas.

*Luckel v. White*⁴ involved the construction of a 1935 royalty deed under which Mary Etta Mayes granted to L. C. Luckel, Jr., his heirs and assigns, an undivided 1/32 royalty interest in 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 1/4 of any and all royalties paid under such lease. The deed further provided that Mayes reserved the executive right and the right to all bonuses and rentals paid under any future oil and gas leases. The deed also expressly stated that Luckel was entitled to 1/4 of any and all royalties reserved under any future leases. Subsequent leases covering the property provided for a 1/6 royalty, rather than 1/8, 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 1/32 undivided royalty interest. Luckel's successors, on the other hand, asserted entitlement to a 1/24 royalty interest under such leases.

The granting clause in the royalty deed clearly conveyed an undivided 1/32 royalty interest. However, the future lease clause was capable of being interpreted to entitle the grantee to a different royalty interest in future leases than that conveyed to the grantee in the granting clause. In *Alford v. Krum*⁵ the Texas supreme court faced a similar conflict between a granting clause and a "future lease" clause contained in a mineral deed. In that case, the supreme court held that the granting clause was the controlling provi-

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1. 35 Tex. Sup. Ct. J. 40 (Oct. 23, 1991).
2. 35 Tex. Sup. Ct. J. 48 (Oct. 23, 1991).
3. 671 S.W.2d 870 (Tex. 1984).
4. 35 Tex. Sup. Ct. J. 40 (Oct. 23, 1991).
5. 671 S.W.2d 870.

sion defining the estate conveyed.⁶ Applying the holding in *Alford v. Krum*⁷ to this case, if the deed's granting clause and future lease clause were construed to be irreconcilable, the grant of a 1/32 royalty interest in the granting clause would control, and Luckel's successors would be entitled only to a 1/32 royalty interest in future leases.

The lower court had previously determined that the granting clause, habendum clause, and warranty clause of the deed conveyed a permanent fixed 1/32 royalty interest and that the future lease clause was ineffective to convey 1/4 of royalties reserved under future leases.⁸ This determination was the result of the court's effort to harmonize the various provisions of the deed and the court's application of *Alford v. Krum*.⁹ In harmonizing the provisions of the deed, the court emphasized that a 1/8 landowner's royalty had been customary at the time the deed was created and reasoned that the parties to the deed probably contemplated that all future leases would provide for the usual and customary 1/8 landowner's royalty.¹⁰ Based on this inference, the court held that the future lease clause was consistent with the granting clause and simply confirmed that the grantee was being conveyed a 1/32 royalty interest, being 1/4 of the usual and customary 1/8 royalty interest.¹¹

Although the supreme court agreed that the parties probably contemplated that future leases would provide for the usual and customary 1/8 royalty,¹² the court disagreed with the result reached by the court of appeals.¹³ Noting that it is not the actual intent of the parties that governs construction of the deed, but the intent of the parties expressed in the instrument,¹⁴ the supreme court found that the term "one-fourth of any and all royalties reserved under" future leases is clear and unambiguous, and had the effect of granting to Luckel 1/4 of any and all royalties reserved under future leases.¹⁵ Additionally, the court noted that one clause does not necessarily control over another simply because it is the granting clause and that the language in the future lease clause is as effective to grant an interest in future leases as is the formal language in the granting clause.¹⁶ The supreme court therefore concluded that "the court of appeals erred in 'harmonizing'

6. *Id.* at 872.

7. *Id.*

8. *Luckel v. White*, 792 S.W.2d 485, 491 (Tex. App.—Houston [14th Dist.] 1990), *rev'd*, 35 Tex. Sup. Ct. J. 40 (Oct. 23, 1991).

9. *Id.* at 490-91.

10. *Id.* at 490. "For many years the customary landowner's royalty was a 1/8th reservation. This practice was so common that the courts had judicial knowledge that 'the usual royalty provided in mineral leases is one-eighth.'" *Id.* (quoting *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)).

11. *Id.* at 490-91.

12. *Luckel*, 35 Tex. Sup. Ct. J. at 42.

13. *Id.*

14. *Id.* at 43.

15. *Id.*

16. *Id.*

the 'future lease' clause to alter its clear and unambiguous meaning."¹⁷

The supreme court then addressed the application of its decision in *Alford v. Krum*.¹⁸ That case dealt with a mineral deed in which the granting clause conveyed "one-half of the one-eighth interest" and the future lease clause provided that, with regard to future leases covering the land, the grantor and grantee would each own "a one-half interest."¹⁹ The supreme court held in *Alford* that the granting clause conflicted with the future lease clause and that the granting clause, which defined the conveyed estate, controlled over the future lease clause.²⁰

Reconsidering its opinion in *Alford*, the court concluded that it had incorrectly failed to harmonize the provisions of the deed under the four corners rule²¹ and erred in disregarding the future lease clause.²² On this basis, the court overruled *Alford* and concluded that in this case the interest conveyed under the royalty deed at issue was 1/4 of royalties reserved under the existing and all future leases.²³ The court further concluded that since the granting clause granted a 1/32 fixed royalty, the parties intended that the undivided 1/4 royalty under future leases would never fall below that amount.²⁴ Accordingly, Luckel's royalty interest under future leases is subject to a floor of 1/32 of production.²⁵

In *Jupiter Oil Co. v. Snow*²⁶ the supreme court considered similar issues in the context of construing the size of the mineral interest conveyed under a 1918 mineral deed from J. W. and Malinda Henderson, grantors, to J. M. Weaver, grantee.

Through a series of assignments, the interest of Weaver, the original grantee, was conveyed to Jupiter. Snow, an oil operator, obtained oil, gas, and mineral leases covering the lands, and proceeded to complete two producing wells under those leases. Snow failed to lease the mineral interest held by Jupiter. Jupiter, as an unleased mineral owner, sought reimbursement from Snow for its proportionate share of the net value of the hydrocarbons produced by Snow from the property. Jupiter, claiming to own an undivided 1/2 mineral interest in the property, alleged it was entitled to \$572,377.98, attributable to that interest after all offsets. Snow claimed that under the granting clause of the mineral deed, Jupiter merely owned a 1/16 mineral interest and was entitled to only \$59,922.60, allocable to that interest after all offsets. The trial court held that Jupiter owned a 1/2 mineral

17. *Id.*

18. *Id.* at 43 (discussing *Alford v. Krum*, 671 S.W.2d 870).

19. *Alford*, 671 S.W.2d at 871-72.

20. *Id.* at 873-74.

21. *Luckel*, 35 Tex. Sup. Ct. J. at 44. The four corners rule requires the court to construe the deed according to the intent of the parties as expressed solely within the instrument, giving credit to every phrase and reconciling any conflicting clauses in an attempt to harmonize all language appearing in the instrument. *Garrett v. Dils Co.*, 157 Tex. 92, 299 S.W.2d 904, 907 (1957).

22. 35 Tex. Sup. Ct. J. at 44.

23. *Id.*

24. *Id.* at 44-45.

25. *Id.*

26. 35 Tex. Sup. Ct. J. 48 (Oct. 23, 1991).

interest in the tract.²⁷ The court of appeals, however, reversed based upon an application of *Alford v. Krum*.²⁸

Reading the deed as a whole,²⁹ the supreme court found that the granting clause in the 1918 deed conveyed to Weaver a 1/16 interest in the mineral estate, and in the absence of further language in the deed, the fee simple title as to 15/16 of the minerals would revert to the Hendersons upon the termination of the then-existing lease.³⁰ However, the future lease clause under the deed conveyed the Hendersons' possibility of reverter with regard to 7/16 of the minerals.³¹ This had the effect of expanding Jupiter's interest in the mineral estate from 1/16 to a full 1/2 upon termination of the then-existing lease.³² Under this analysis, the supreme court held that the deed was unambiguous, and that none of its clauses irreconcilably conflicted.³³ Accordingly, the court held that the court of appeals erred in resorting to rules of construction, such as the repugnant to the grant rule.³⁴ The supreme court reversed the court of appeals' judgment, and affirmed the judgment of the trial court.³⁵

B. Open Mine Doctrine

One of the issues in the will construction case of *McGill v. Johnson*³⁶ was the application of the open mine doctrine³⁷ to the particular facts involved.

27. *Id.* at 49.

28. *Jupiter Oil Co. v. Snow*, 802 S.W.2d 354 (Tex. App.—Eastland 1990), *rev'd*, 35 Tex. Sup. Ct. J. 48 (Oct. 23, 1991). The appellate court reluctantly followed the *Alford* case, respectfully suggesting that the supreme court should re-examine its holding. *Id.* at 358.

29. The deed's granting clause conveyed "all that certain undivided 1/16 interest in and to all the oil, gas, and other minerals." *Id.* at 355-56. The deed's "subject to clause," however, stated that "[i]t is the intention of the parties in the conveyance that the grantee herein is to receive 1/16 part of the oil, gas, or other mineral of whatsoever kind and character produced by the holder of the lease now on said land, that grantors herein now intend to convey 1/2 of the interest they now have in any such production under said lease." *Id.* at 356. The deed's future lease clause provided that "it is the intention of the grantors herein that in the event said lease [the then-existing lease covering the property] is forfeited, then in that event the grantee is to have and hold an equal undivided one half of all such minerals." *Id.*

30. 35 Tex. Sup. Ct. J. at 50.

31. *Id.*

32. *Id.*

33. *Id.*

34. *Id.* The Texas supreme court expressly held that *Alford v. Krum* was inapplicable. *Id.* at 48.

35. *Id.* at 48.

36. 799 S.W.2d 673 (Tex. 1990).

37. The court explained the open mine doctrine as follows:

The open mine doctrine provides a limited exception to the general rule that a life tenant is liable to the remaindermen for waste if he uses the corpus of the estate. Texas courts have applied the open mine doctrine only to leases that the testator executed and that are in effect at his death. *Moose v. Vines*, 474 S.W.2d 437 (Tex. 1971). The open mine doctrine rests on a presumption of intent that when the creator of the life estate gave no direction as to disposition of the proceeds from open mines, he intended for the life tenant to have the same degree of control over such proceeds as that of the testator. The effect of the open mine doctrine is that all royalties, bonuses, and income derived from these royalties and bonuses is not treated as corpus of the life estate, but rather, belongs to the life tenant. *Clyde v. Hamilton*, 414 S.W.2d 434 (Tex. 1967).

799 S.W.2d at 676.

Prior to his death, the testator in that case executed ten oil, gas, and mineral leases as to his interest. Upon his death, the testator's interest in the leases was transferred to a testamentary trust. The testator's son, Johnson, was the income beneficiary of that trust. The trustee was specifically authorized by the trust documents to execute oil, gas, and mineral leases, and the trustee granted two leases during the term of the trust. The trust terminated by its own provisions on Johnson's fortieth birthday. At that time, in accordance with the provisions of the will, all of the personal property formerly held in trust was transferred to Johnson, and the real property was placed in a life estate of which Johnson was the life tenant, with the remainder passing to the testator's sisters. After creation of the life estate, Johnson received all bonus and royalty payments under the oil, gas, and mineral leases as his own property.

The McGills succeeded to the interest of one of the testator's sisters. They claimed that under a general rule of life tenancy, Johnson committed waste by dissipating the corpus of the life estate by taking royalties and bonuses under the leases without sharing them with the remaindermen. The McGills recognized that the open mine doctrine was an exception to this general rule but claimed that it did not apply in this case because the life estate was not created until after termination of an intervening trust.

In this case of first impression, the Texas supreme court held that the intervening trust did not preclude application of the open mine doctrine since the trustee was expressly authorized to execute oil, gas, and mineral leases during the term of the trust.³⁸ This holding was further based on the fact that under the provisions of the will, the testator intended for his son to receive all of the personal property from the estate and to use the real property during the son's lifetime.³⁹ Therefore, the court concluded that Johnson did not commit waste.⁴⁰

C. Mineral Interest/Royalty Interest Distinction

At issue in *Neel v. Alpar Resources, Inc.*⁴¹ was the classification of a certain reservation in a warranty deed as a mineral interest or a royalty interest. In 1938, the Federal Land Bank of Houston (FLB) granted a warranty deed to C.A. Wilhelm, reserving a certain interest.⁴² Nan Shaw succeeded to the

38. *Id.* at 677.

39. *Id.* at 676-77.

40. *Id.* at 677.

41. 797 S.W.2d 361 (Tex. App.—Amarillo 1990, no writ).

42. The reservation provided:

SAVE AND EXCEPT an undivided one-sixteenth (1/16th) interest (same being one half (1/2) of the usual (1/8) royalty) in and to all of the oil, gas and other minerals, in, to and under and that may be produced from the land herein conveyed to be paid or delivered unto said Bank as its own property free of cost to it from royalty oil, gas and/or other minerals FOREVER, together with the right of ingress and egress, at all times for the purpose of storing, treating, marketing and removing the same therefrom. Said interest in and to said minerals hereby reserved is a non-participating royalty interest and shall not participate in the bonus paid for any oil, gas or other mineral lease covering said land, nor shall it participate in the money rentals which may be paid to extend the time within

interest of Wilhelm under the deed. In 1964, Shaw conveyed the property by deed to LaRue Young, reserving an undivided 1/2 interest in and to all of the oil, gas, and other minerals in and under, and that may be produced from the land. This deed did not mention the outstanding interest reserved by the FLB. The Neels succeeded to the interest reserved by Shaw. In 1971 and 1972, the Neels and the successors of Young granted separate oil, gas, and mineral leases to Alpar's predecessor in interest. These leases provided for a 1/8 royalty and contained a proportionate reduction clause.

The Neels claimed that the interest reserved by the FLB was an undivided 1/16 mineral interest rather than an undivided 1/16 royalty interest. According to the Neels, they owned an undivided 7/16 mineral interest. It was undisputed that Young's successors owned an undivided 1/2 mineral interest. Under the Neels' theory, they would be entitled to 7/16 of 1/8 royalty interest under their lease held by Alpar, and the FLB would be entitled to 1/16 of 1/8 royalty interest. Alpar, on the other hand, asserted that the 1938 reservation entitled the FLB to 1/16 royalty interest, being 1/2 of 1/8 royalty. Consequently, it was Alpar's position that the Neels would be entitled to nothing since the Neels only owned 1/2 mineral interest and the lease provided for 1/8 royalty.

The Neels' claim was based on several contentions. First, they contended that the interest reserved by the FLB could not be a royalty interest because the deed did not contain the limiting language that the 1/16 interest would be paid from actual production. The court, however, stated that the words "from actual production" are not exclusive words of art which must be used in order to reserve a royalty rather than a mineral interest.⁴³ Instead, the parties' intent, as expressed in the deed, controls.⁴⁴ The court noted that the description of the reserved interest in the case at hand made it clear that the reserved interest would be paid out of actual production.⁴⁵

Second, the Neels pointed to the FLB's reservation of the right of ingress and egress as indicating that it was reserving a mineral interest rather than a royalty interest. Noting that the reservation of ingress and egress was limited for the purposes of storing, treating, marketing, and removing royalty oil, gas, or other minerals, the court held that such reservation was not inconsistent with a reserved royalty interest and did not necessarily indicate an intent to reserve a mineral interest.⁴⁶

Third, the Neels asserted that other documents, such as the FLB's deed of trust, the FLB's release of the deed of trust, and all subsequent deeds out of the FLB, should be examined to ascertain the true nature of the reserved

which a well may be begun under the terms of any lease covering said land. In the event oil, gas and/or other minerals are produced from said land, then said Bank shall receive a full one-sixteenth (1/16th) portion thereof as its own property, to be paid or delivered to said Bank free of cost to it.

Id. at 362 (emphasis omitted).

43. *Id.* at 364.

44. *Id.*

45. *Id.*

46. *Id.* at 365.

interest. The court rejected this contention as well, holding that the deed is the final "repository" of the terms and conditions to which the parties have agreed, and, in the absence of fraud or mistake, the deed alone will be deemed to express the true intent of the parties thereto.⁴⁷ Since there were no allegations of fraud or mistake, the appellate court held the evidence of the provisions of the collateral documents had been properly excluded by the trial court.⁴⁸

The court held that the FLB reservation was a 1/16 non-participating royalty interest, being 1/2 of the usual 1/8 royalty.⁴⁹ The Neels, therefore, owned a 1/2 mineral interest burdened by FLB's 1/16 non-participating royalty interest.⁵⁰ Since the oil, gas, and mineral lease executed by the Neels only provided for 1/8 royalty, the Neels were not entitled to any royalty payments under the lease.⁵¹

D. Adverse Possession

The common source of title in a trespass to try title suit was disputed in *Thomas v. Henderson*.⁵² At issue was the mineral interest in a 100 acre tract of land. The plaintiffs claimed title to the tract, including the mineral estate, by virtue of adverse possession by the plaintiffs' grandparents, Ann and Henry Ford, since December 1938. They alleged that the Fords lived, farmed, and raised cattle on the fenced tract since 1939. The plaintiffs pleaded the 3 year, the 10 year and the 25 year statutes of limitations.⁵³ The defendants asserted title to the minerals under the east half of the tract as a result of warranty deeds and mineral deeds. They alleged that the minerals under the east half had been severed from the surface tract prior to 1939.

At trial, the defendants introduced a 1909 general warranty deed from the Fords to W.J. Simmons and a 1932 mineral deed as to the east half of the tract from Simmons (by an authorized agent) to the defendants' predecessor in interest. The defendants additionally introduced a 1910 deed from Simmons to the Fords which covered the west half of the tract. The plaintiffs claimed that these instruments were inadmissible. The trial court admitted these documents over objection and held that the plaintiffs were entitled to the minerals in the west half of the tract and to the entire surface estate and the defendants were entitled to the minerals in the east half.⁵⁴

On appeal the plaintiffs claimed, among other things, that the title instruments introduced by the defendants were irrelevant and a "nullity" because the defendants did not establish that the Fords had legal title to the tract at the time they executed the deed to Simmons. The plaintiffs' position was

47. *Id.* at 366 (citing *Cherokee Water Co. v. Forderhouse*, 641 S.W.2d 522, 524 (Tex. 1982) and *Carter v. Barclay*, 476 S.W.2d 909, 915 (Tex. Civ. App.—Amarillo 1972, no writ)).

48. *Id.*

49. *Id.*

50. *Id.*

51. *Id.* at 367.

52. 795 S.W.2d 847 (Tex. App.—Beaumont 1990, writ denied).

53. TEX. CIV. PRAC. & REM. CODE ANN. §§ 16.024, .026-.028 (Vernon 1986).

54. *Thomas*, 795 S.W.2d at 848.

that the instruments offered by defendants had no effect unless the defendants could trace the Fords' title in 1909 back to the sovereignty of the soil. The defendants contended that they were not required to prove title back to the sovereignty of the soil because it was only necessary to establish title back to a common source. According to defendants, Simmons was the common source of title because the defendants were claiming title under a mineral deed from Simmons and the plaintiffs were claiming title as heirs of the Fords, who were Simmons' grantees.

The appellate court concluded that the defendants had established a common source of title and that the documents introduced by defendant were properly admitted.⁵⁵ Since the mineral estate had effectively been severed from the surface estate in the east half prior to any claim of adverse possession, the court applied "well-established" rules to conclude that the plaintiffs did not adversely possess the minerals in the east half.⁵⁶ Specifically, according to Texas law, after the severance of the surface estate from the mineral estate, "mere possession of one will not ripen into a limitation title to the other."⁵⁷ Limitations

cannot be successfully asserted against the owner of a severed mineral estate or mineral interest by a surface holder when the surface holder or surface owner perfects his title to the surface by taking actual possession of the surface but fails to take actual possession and use of the minerals for the statutory required period.⁵⁸

Applying these principles, the court affirmed the trial court's award of title.⁵⁹

II. ISSUES INVOLVING OIL, GAS, AND MINERAL LEASES

A. *Royalty Due on Actual Production*

In a case of first impression in Texas courts, the San Antonio court of appeals held in *Killam Oil Co. v. Bruni*⁶⁰ that, as a matter of law, the standard royalty clause in an oil, gas, and mineral lease does not apply to proceeds paid in settlement of claims arising under a take-or-pay provision in a gas purchase contract.⁶¹

The Bruni Mineral Trust in 1974 drafted and entered into an oil, gas, and mineral lease, as lessor, with Killam & Hurd, Ltd., as lessee. The lease was later assigned by Killam & Hurd, Ltd. to Killam Oil Company (Killam) and Hurd Enterprises, Ltd. (Hurd) in equal parts. Two of the wells completed on the lease produced gas that was sold to United Texas Transmission Company (UTTCO) pursuant to a gas purchase contract. The gas contract con-

55. *Id.* at 850.

56. *Id.* at 851.

57. *Id.* (citing *Watkins v. Certain-Teed Prods. Corp.*, 231 S.W.2d 981 (Tex. Civ. App.—Amarillo 1950, no writ)).

58. *Id.* (citing *Carminati v. Fenoglio*, 267 S.W.2d 449 (Tex. Civ. App.—Fort Worth 1954, writ ref'd n.r.e.)).

59. *Id.* at 851-52.

60. 806 S.W.2d 264 (Tex. App.—San Antonio 1991, writ denied).

61. *Id.* at 268.

tained a take-or-pay provision obligating UTTCO to take a certain specified annual quantity of gas or pay for gas not taken. UTTCO failed to take or pay for the minimum quantity but later paid Killam and Hurd \$4 million and \$2.8 million, respectively, to settle their take-or-pay claims.

Thereafter, the Trust sued Killam and Hurd seeking a royalty share of the settlement proceeds received from UTTCO. The Trust alleged a variety of causes of action, including breach of marketing duty, breach of duty of good faith and fair dealing, conversion, fraud, unjust enrichment, and equitable reformation. Both sides moved for summary judgment. The trial court granted summary judgment in favor of the Trust, concluding that, as a matter of law, the gas royalty clause applied to take-or-pay settlement payments.⁶² The trial court denied the Trust's motion for summary judgment with regard to its claims for breach of covenant to manage and market, and breach of duty of good faith. Killam and Hurd appealed.⁶³

Noting that the royalty provision in the oil, gas, and mineral lease determines the royalties to which a lessor is entitled, the appellate court examined the particular royalty provision at issue.⁶⁴ In the absence of prior Texas case law on the issue of whether a stated royalty clause applies to take-or-pay settlements, the court turned to Texas cases dealing with similar issues.

The court first considered *Monsanto Co. v. Tyrrell*,⁶⁵ where the issue was whether an advance payment for gas production constituted "recovery from production."⁶⁶ That issue arose because the oil and gas lease provided for the initial royalty to increase when the lessee recovered its total drilling costs from a stated percentage of production. Under the gas purchase contract entered into by the lessee, the gas purchaser made an advance payment to the lessee as partial payment for the gas committed to the purchaser. The lessor contended that the advance payments should be applied as an immediate credit for the recovery of well costs, thereby triggering the increased royalties. The court, however, ruled that the advance payments were not "recovery from production" and, therefore, they would not be accounted for by the lessee as recovery of expenses until the associated gas was actually produced or extracted from the ground.⁶⁷

Similarly, the court considered the decision in *Exxon Corp. v. Middleton*,⁶⁸ where the royalty clause at issue provided for royalty to be based upon a percentage of the gas produced from the land as related to either the

62. *Id.* at 265-66.

63. *Id.* at 266.

64. The pertinent provision stated:

The royalties to be paid by lessee are: . . . (b) on gas, including casinghead gas and all gaseous substances, produced from said land and sold or used off the premises or in the manufacture of gasoline or other product therefrom, the market value at the mouth of the well of one-eighth of the gas so sold or used provided that on gas sold at the wells the royalty shall be one-eighth of the amount realized from such . . .

Id. at 266 (emphasis omitted).

65. 537 S.W.2d 135 (Tex. Civ. App.—Houston [14th Dist.] 1976, writ ref'd n.r.e.).

66. 806 S.W.2d at 267.

67. 537 S.W.2d at 137.

68. 613 S.W.2d 240 (Tex. 1981).

amount realized for the sale of minerals at the well or market value if the minerals were sold off the premises.⁶⁹ The lessor in that case contended that the gas was sold when the gas contracts became effective. The Texas supreme court disagreed, holding that the term "produced," as used in the lease, meant a physical extraction from the land and the term "sold" meant delivered.⁷⁰ The lessee's obligation under the royalty clause was therefore held to be unaffected by the gas contracts.⁷¹

The court also considered a recent federal case in which the Fifth Circuit held that a standard gas royalty clause does not apply to take-or-pay payments because " 'royalties are not owed unless and until actual production, the severance of minerals from the formation, occurs.' "⁷²

In the present case, the court found that the royalty provision applied to gas actually *produced* or physically extracted from the soil and that the take-or-pay settlement payments by UTTCO were for gas *not* produced.⁷³ Additionally, the court emphasized that the Trust drafted the lease and it could have included a provision specifically allowing for royalty to be paid on take-or-pay settlements.⁷⁴ The court did observe, however, that gas not actually produced remains in the ground and that the Trust will be entitled to royalties when and if the gas is actually produced.⁷⁵

B. *Accrued Royalty and Lease Termination*

In *Marifarms Oil & Gas, Inc. v. Westhoff*⁷⁶ the court of appeals affirmed the trial court's judgment awarding a royalty owner recovery of accrued royalties in the amount of \$347.00 and terminating the oil, gas, and mineral lease under which those royalties were payable due to non-production of hydrocarbons for a period of 84 days.⁷⁷

1. *Notice of Change of Interest*

In *Marifarms Oil & Gas, Inc.* Marifarms Oil & Gas 1977 (the Partnership) was the working interest owner under the oil, gas, and mineral lease at issue. Marifarms Oil & Gas, Inc. (the Corporation) was the operator of the lease. Westhoff purchased the property burdened by the lease in 1986. Thereafter, Westhoff sent notice to the Corporation of the change of interest, believing that the Corporation held the working interest under the lease because the local taxing authority records listed the Corporation as both the operator of the lease and the working interest owner. Westhoff sent this notice to the Corporation's mailing address listed in the taxing records. This was the for-

69. 806 S.W.2d at 267.

70. 613 S.W.2d at 244.

71. *Id.* at 245.

72. *Killam Oil Co.*, 806 S.W.2d at 267 (quoting *Diamond Shamrock Exploration Corp. v. Hodel*, 853 F.2d 1159, 1165 (5th Cir. 1988)).

73. *Id.*

74. *Id.* at 267-68.

75. *Id.* at 268.

76. 802 S.W.2d 123 (Tex. App.—Fort Worth 1991, no writ).

77. *Id.* at 124.

mer address of the Corporation but remained the residence address of the Corporation's sole employee. Although the Corporation's address had changed, the Corporation had not advised the taxing authority, nor had the Corporation corrected the taxing authority's mistake in listing it on its records as the working interest owner of the lease. Thereafter, having received no royalty payments under the lease, Westhoff filed suit to recover all accrued royalties and to cancel the lease due to an alleged cessation of production. Westhoff was awarded judgment by the trial court.⁷⁸

On appeal, the Partnership and the Corporation (collectively "Marifarms") claimed that the trial court had erred in rendering judgment for recovery of the accrued royalties because Westhoff had only notified the Corporation (the operator of the lease) of the change of ownership interest and had failed to notify the Partnership (the true owner of the working interest) of this development. On the basis of the facts stated above, the court of appeals held that there was sufficient evidence to support the trial court's judgment awarding recovery of the royalties because such evidence demonstrated that the Corporation appeared to be the owner of the working interest and that Westhoff had exercised due diligence in attempting to notify the Corporation of the change in ownership.⁷⁹

2. Cessation of Production

With regard to the lease termination issue, Marifarms contended that the trial court erred in terminating the lease because there was insufficient evidence that the well had ceased to produce in paying quantities. The evidence, however, established that the well had been shut-in for a period of 84 days from June 3 to August 25, 1986. In addressing this issue, the court noted that a lease will not terminate for lack of production resulting from a shut-in well if the shut-in royalty is paid in compliance with an applicable lease provision.⁸⁰ In such circumstances, however, the court noted that the shut-in royalty must be paid in advance of the expiration of the time period provided by the cessation of production clause in order to perpetuate the lease.⁸¹ In this instance, no shut-in royalty was paid by Marifarms prior to the expiration of the sixty day period provided for under the lease's cessation of production clause, and in fact, no shut-in royalty had ever been paid by Marifarms. Thus, for approximately eighty-four days, there had been a total absence of production and no shut-in royalty had been paid. On this basis, the court of appeals affirmed the trial court judgment declaring that the lease had terminated by its own provisions.⁸²

In *Bachler v. Rosenthal*⁸³ the court of appeals reversed the trial court's granting of a summary judgment for the lessees which decreed as a matter of law that an oil, gas, and mineral lease had not terminated due to cessation of

78. *Id.*

79. *Id.*

80. *Id.* at 125.

81. *Id.* at 125-26.

82. *Id.* at 126.

83. 798 S.W.2d 646 (Tex. App.—Austin 1990, writ denied).

production.⁸⁴ The lease in question had been extended beyond the primary term as result of actual production. Thereafter, production declined and actually ceased for a period of time prior to being restored as the result of reworking operations. The lessors filed suit claiming that the lease had terminated because production had completely ceased for more than sixty days before reworking operations were conducted. The lease contained a typical clause providing that the lease would terminate upon the cessation of production for more than sixty consecutive days beyond the primary term.⁸⁵

In reversing the trial court, the court of appeals distinguished between a lease termination based upon a cessation of production in paying quantities and a lease termination based upon a total cessation of production.⁸⁶ With regard to the former, the court stated that a determination of whether there has been a termination of the lease depends upon: (1) whether revenues from production have exceeded operating and marketing expenses over a reasonable period of time; and (2) whether under relevant circumstances a reasonable prudent operator would, "for purposes of making a profit and not merely for speculation, continue to operate [the lease]."⁸⁷ The court noted that a determination of whether a lease has terminated due to a total cessation of production, however, simply requires a determination of whether the lease has completely failed to produce hydrocarbons for the period of time (typically sixty days) provided for under the clause contained in the lease.⁸⁸

Thus, if there has been a total cessation of production for the time specified in the lease and an absence of further drilling or reworking operations, the lease terminates automatically.⁸⁹ If, on the other hand, production from the lease has not completely ceased but instead has simply been in such small amounts as to cause the lease to be operated at a loss, the lease may be declared terminated only if such operating losses have continued for an unreasonable length of time and a reasonable prudent operator would not continue to operate the lease for the purpose of making a profit.⁹⁰

Applying these principles to the summary judgment record, the court of appeals held that the evidence did not conclusively establish the absence of a period of sixty consecutive days with no actual production.⁹¹ In this regard, the summary judgment evidence established that the lease in question produced one barrel of oil in January 1987, zero barrels of oil in February 1987, and twelve barrels of oil in March 1987. The summary judgment evidence,

84. *Id.* at 647.

85. The lease provided:

[I]f after discovery and production of oil, gas or other mineral [on said land], the production thereof should cease from any cause, this lease shall not terminate if Lessee commences operations for drilling or reworking within sixty (60) days thereafter

Id. at 648 (emphasis omitted).

86. *Id.* at 649.

87. *Id.* (quoting *Clifton v. Koontz*, 160 Tex. 82, 325 S.W.2d 684, 690-91 (1959)).

88. *Id.* at 650.

89. *Id.*

90. *Id.* at 649-50.

91. *Id.* at 651.

however, did not establish the exact day in January that the one barrel of oil had been produced and did not establish the exact day or days in March that the twelve barrels of oil had been produced. As a result, the court concluded that the summary judgment record left open the possibility that the January production and the March production had occurred more than 60 days apart and did not conclusively establish that the lease had not terminated.⁹²

C. Executives

1. Duty of Executives

In *Mims v. Beall*⁹³ the court of appeals affirmed a trial court judgment that the owners of the executive right breached their obligation to the non-executives by leasing the mineral property to their son on terms which did not reflect current market conditions.⁹⁴ In 1947, the Bealls' parents sold approximately 200 acres of land to John and Chattie Mims, retaining an undivided 1/4 nonparticipating royalty interest. Some time after that, the Mims granted an oil, gas, and mineral lease to SESCO Production Company covering the property. Such lease, which provided for 1/8 royalty and 1/8 overriding bonus royalty, apparently expired prior to 1979. In 1979, oil and gas exploration activities in the area of the 200 acre tract increased. That same year, the Mims granted an oil, gas, and mineral lease to their son, Angus Mims. This lease provided for a 1/8 royalty and no cash bonus. Shortly thereafter, Angus Mims assigned the lease to a third party in return for a 1/16 overriding royalty interest. The Bealls filed suit against John, Chattie, and Angus Mims, alleging that their conduct constituted a breach of executive duty. Following a jury trial, the court rendered judgment in favor of the Bealls, awarding actual and exemplary damages and imposing a constructive trust on part of the overriding royalty interest obtained by Angus.⁹⁵ The Mims appealed.

The court of appeals recognized that one who exercises executive rights to lease or develop mineral property owes a duty of utmost good faith to the non-executives⁹⁶ and held that such duty is equivalent to a fiduciary obligation.⁹⁷ The court then examined the evidence to determine whether it was sufficient to support the jury finding that the Mims breached their duty to the Bealls.

The court found sufficient evidence of a breach of the executive's duty in three respects.⁹⁸ First, as fiduciaries, the court held that the Mims were prohibited from self dealing and from dealing with other persons whose interests are closely identified with their own, such as their son, and that this was sufficient evidence for the jury to find that the Mims engaged in self

92. *Id.*

93. 810 S.W.2d 876 (Tex. App.—Texarkana 1991, no writ).

94. *Id.* at 882.

95. *Id.* at 878.

96. *Id.*

97. *Id.* at 878-79 (citing *Manges v. Guerra*, 673 S.W.2d 180 (Tex. 1984)).

98. *Id.* at 880.

dealing by leasing to their son.⁹⁹ Second, the court held that the evidence was sufficient for the jury to find that the Mims had failed to negotiate a lease based on current market terms.¹⁰⁰ In this respect, the court noted that the geographic area was a "hot" location for mineral development in 1979 and that some tracts in the area had been leased for larger royalties than the 1/8 royalty provided for under the Mims lease.¹⁰¹ The fact that Angus Mims almost immediately marketed the lease to a third party for an overriding royalty interest was further evidence that the 1/8 royalty was less than what the market would bear in terms of a royalty burden, and, in fact, John Mims admitted that there had been no arms length negotiation for the lease. Third, the court held that the executive right owner failed to exact for the non-participating royalty owners every benefit he exacted for himself in that the overriding royalty interest received by Angus had not been shared with the Bealls.¹⁰² Because Angus was considered as having the same interest as his parents, the Bealls were deprived of 1/4 interest in the overriding royalty reserved by Angus.¹⁰³

Although the court recognized that Angus did not owe a fiduciary duty to the Bealls,¹⁰⁴ it nevertheless found that Angus could be liable to the Bealls for his participation in his parents' breach of executive duty,¹⁰⁵ reasoning that if the lessee "agrees with the executive to an arrangement made for the purpose of excluding or minimizing the benefits of an outstanding or non-participating interest owner, the lessee can be held liable to the injured third party."¹⁰⁶ In fact, the court noted that some authorities would impose liability even if the lessee should have only reasonably been aware that the executive was acting in breach of his duty.¹⁰⁷ The evidence showed that Angus had at least constructive notice that his parents were breaching their executive duty.¹⁰⁸ Accordingly, the court found sufficient evidence to support the jury's liability finding.¹⁰⁹ The remainder of the opinion focused on remedies awarded by the trial court.¹¹⁰

2. *Appointment of Executives*

In *Hawkins v. Twin Montana, Inc.*¹¹¹ the court of appeals affirmed the trial court's interlocutory order appointing a receiver for the purpose of exercising the executive right with regard to certain property.¹¹² The appellants owned the surface of a tract of land, the right to execute oil and gas

99. *Id.*

100. *Id.*

101. *Id.*

102. *Id.*

103. *Id.*

104. *Id.*

105. *Id.* at 881.

106. *Id.* at 880-81.

107. *Id.* at 881.

108. *Id.*

109. *Id.*

110. *Id.* at 881-82.

111. 810 S.W.2d 441 (Tex. App.—Ft. Worth 1991, no writ).

112. *Id.* at 443.

leases with regard to the tract, and the right to receive all bonuses and rentals under any such lease. The appellees owned the non-executive mineral interest in the tract. Twin Montana, the appellee, petitioned the trial court for a judgment declaring the respective rights of the parties and for the appointment of a receiver of the executive rights. During the pendency of the lawsuit, the trial court appointed such a receiver.¹¹³

The appellants appealed from the trial court's order on several grounds. Raising some peripheral issues, the appellants claimed that the trial court had erred in appointing a receiver in this case because: (1) the trial court had no authority to impose an equitable receivership under the facts of this case, particularly when, as here, the appointment of a receiver was the primary, not ancillary, relief sought by the plaintiff; and (2) the appellees had failed to establish that any well drilled on the property would yield a profit for the lessee.

The court of appeals made short work of these contentions. With regard to the former contention, the court held that the receivership at issue was not an equity receivership but a statutory receivership imposed under the Texas Civil Practices and Remedies Code,¹¹⁴ which authorizes the appointment of a receiver in an action between parties jointly interested in the property and that the parties had the requisite joint interest in the property to enable the trial court to grant the statutory relief.¹¹⁵ As to the matter of whether the receivership was the primary or ancillary relief sought by the appellees, the court noted that in addition to the appointment of a receiver, the appellees were seeking permanent relief in the form of declaratory judgment specifying the rights of the parties as between the executives and non-executives and, for this reason, rejected the appellants' contention.¹¹⁶ With respect to the claim that the receivership had been improperly ordered because the appellees had failed to plead and prove that any wells drilled on the property would be sufficiently productive to make a profit for the lessee, the court held that the profitability of operations under any prospective lease was not a requirement for the granting of a receivership or the execution of any such lease and thus easily dispatched this claim as well.¹¹⁷

At the heart of the appeal lay the appellants' contention that the trial court erred in appointing a receiver to execute an oil and gas lease covering the premises because after suit was filed they had in fact granted a lease covering the property to L.F. Jones Company after first rejecting appellees' offer to lease the property. The Jones lease provided for a primary term of two years, a 1/8 royalty, \$100 per acre bonus, and surface damages in the amount of \$3,000 for the first well and \$1,000 for each additional well. The lease offered by the appellees provided for a primary term of one year, a 1/4 royalty, \$100 per acre bonus, and \$500 per well for surface damages.

113. *Id.*

114. TEX. CIV. PRAC. & REM. CODE ANN. ch. 64 (Vernon 1986).

115. *Hawkins*, 810 S.W.2d at 444.

116. *Id.* at 444-45.

117. *Id.* at 445.

The trial court determined that the Jones lease failed to adequately protect the appellees and concluded that the executives had breached their fiduciary duty by entering into the lease.¹¹⁸ The appellants claimed that in this regard the trial court had erred because the executives had complied with the only express condition to the exercise of the executive right, which was that any lease executed on the property had to provide for a royalty of at least 1/8. In addressing this point, the court held that circumstances may require more of an executive than mere compliance with express conditions in order for the executive to discharge its duties in good faith.¹¹⁹ On this basis, the court affirmed that the executives had not acted in good faith when they leased the property for a 1/8 royalty instead of accepting the appellees' lease offer which included a 1/4 royalty.¹²⁰

D. Mistake of Release of Lease

In *Hayes v. ETS Enterprises, Inc.*¹²¹ the court of appeals affirmed the trial court's judgment granting rescission of an instrument by which a lessee released a producing oil, gas, and mineral lease on the grounds that the release was the product of mistake.¹²² Cecil and Emma Jean Meadows, as lessors, granted an oil, gas, and mineral lease to Tom L. Scott, Inc., as lessee. Scott's interest in the lease was later assigned to Pogo Producing Company. Hayes and others owned undivided mineral interests in the Meadows Tract, subject to the oil, gas, and mineral lease.

Pogo Producing Company acquired the working interest under such lease. On February 20, 1985, Pogo farmed out its interest in the lease to ETS, and on April 5, 1985, ETS commenced drilling operations on the tract. Neither the farmout arrangement nor information regarding the commencement of drilling operations was contained in Pogo's lease file although it was Pogo's normal office procedure to make a notation of such information in the file. Without the benefit of such information, a Pogo employee prepared a release of lease and forwarded it to Kenneth Good, the Pogo employee authorized to sign such releases. Good executed the release of the lease on May 14, 1985, during the course of drilling operations. Subsequently, on June 24, 1985, Pogo executed an instrument entitled "Revocation and Rescission of Release of Oil and Gas Lease." By such instrument, Pogo stated that it had not intended to release the lease. ETS completed a producing well on the tract in December 1985, and, on March 19, 1986, Pogo assigned ETS the interest it earned under the farmout, reserving an overriding royalty interest.

ETS brought an action against Hayes and the other mineral interest owners seeking a declaratory judgment that Pogo's release of the lease was ineffective because it was the result of a mistake. ETS then sought and obtained

118. *Id.*

119. *Id.*

120. *Id.*

121. 809 S.W.2d 652 (Tex. App.—Amarillo 1991, writ denied).

122. *Id.* at 660.

a favorable summary judgment in this regard.¹²³ Hayes and the other interest owners appealed.

On appeal, Hayes claimed that the summary judgment evidence did not establish that there was any mistake in the execution of the release. Hayes relied on the deposition testimony of Kenneth Good, who testified that at the time he executed the release, he intended to do so, and that, by his execution of the release, he intended to surrender Pogo's interest in the lease. Hayes asserted that this evidence established that the execution of the release was an intentional act and not a mistake, or at least that this evidence raised a fact issue as to whether there was a mistake. The appellate court rejected this contention, noting that the question of Good's intent in actually executing the document was not an issue.¹²⁴ Rather, the court described the issue as being whether "subsequent to the execution of the farmout agreement from Pogo to ETS, and while ETS was in the process of drilling a test well . . . an employee of Pogo mistakenly and inadvertently prepared, executed and sent for filing a document entitled 'Release of Oil and Gas Leases.'" ¹²⁵ The court found that the summary judgment proof established an objective explanation for the mistake and this was sufficient to establish that the execution of the release was the result of a mistake.¹²⁶

Hayes also claimed that ETS failed to show that:

- (1) the mistake is of so great consequence that to enforce the contract as made would be unconscionable; (2) the mistake relates to a material feature of the contract; (3) the mistake must have been made regardless of the exercise of ordinary care; and (4) the parties can be placed in status quo in the equity sense, *i.e.*, rescission must not result in prejudice to the other party except for the loss of his bargain.¹²⁷

Hayes asserted that ETS's summary judgment evidence failed to establish as a matter of law that the mistake would have been made despite the exercise of ordinary care. The appellate court, however, held that ordinary negligence does not bar the granting of equitable relief¹²⁸ and, adopting the reasoning of Oklahoma courts¹²⁹ on this issue, held that a lessee which has inadvertently executed a release of lease is:

entitled to cancellation of the release unless (1) the cancellation would offend the rights of an innocent purchaser for value or (2) another party in good faith and in innocent reliance, *i.e.*, reliance without notice or knowledge of facts which would suggest the probability of an invalid release, had made a position alteration that could not be reversed with-

123. *Id.* at 654.

124. *Id.* at 657.

125. *Id.*

126. *Id.* at 658.

127. *Id.* at 658. Hayes asserted that the case of *Roland v. McCullough*, 561 S.W.2d 207, 213 (Tex. Civ. App.—San Antonio 1977, writ ref'd n.r.e.), required Twin Montana to establish these elements in order to be entitled to the relief sought. *Hayes*, 809 S.W.2d at 658.

128. *Id.* at 659 (citing *James T. Taylor and Son, Inc. v. Arlington Ind. School Dist.*, 160 Tex. 617, 335 S.W.2d 371, 375 (1960)).

129. See *Armbruster v. Thetis Energy Corp.*, 675 P.2d 476 (Okla. App. 1983); *Mobil Oil Corp. v. Flag-Redfern Oil Co.*, 522 P.2d 651 (Okla. App. 1973).

out significant prejudice.¹³⁰

Finding that the summary judgment evidence in the case was sufficient to show that Hayes and other interest owners made no detrimental position change in innocent reliance on the Pogo release,¹³¹ the court affirmed the trial court's summary judgment.¹³²

III. ISSUES INVOLVING POOLING

A. *Compulsory Pooling*

The Texas supreme court in *Railroad Commission of Texas v. Pend Oreille Oil & Gas Co., Inc.*¹³³ held that the Railroad Commission has the statutory authority to force pool, in a single proceeding under the Mineral Interest Pooling Act (MIPA),¹³⁴ separate deposits of gas in man-made communication through a common wellbore.¹³⁵ Pend Oreille is the working interest owner and unit operator of the Bennett Unit in the Limes (Wilcox 9900) Field in Live Oak County, Texas. Bill Forney is the lessee of land immediately adjacent to the unit. The Limes Field consists of two separate reservoirs, the Main Sand and the Stray Sand. Most of the Bennett Unit is within the Limes Field, but only a small portion of the Forney lease is in the field. Production allowables for the producing well in the unit were based on surface acreage.

In November 1983, Pend Oreille filed application with the Texas Railroad Commission for determination of the productive limits of the field and sought allowables based on productive net acre-feet of reserves. In December 1983, Forney made a written offer to Pend Oreille and other interest owners in the unit to voluntarily pool Forney's productive acreage with productive acreage in the Bennett Unit to form a new unit. Forney proposed that the producing portions of such unit be based on the outcome of Pend Oreille's application or, alternatively, on agreement between the parties. Pend Oreille never responded to Forney's offer.

Forney filed application with the Texas Railroad Commission to force pool under MIPA. Forney's application sought an order establishing a 340 acre unit composed of producing acreage from the Bennett Unit and the Forney tracts. In April 1984, the Railroad Commission held hearings on Forney's application. In May 1984, the Commission temporarily abated further MIPA proceedings until resolution of Pend Oreille's productive acreage application and entered an interim order that

- (1) established that 289 acres of the Bennett Unit and 36 acres of the Forney acreage are productive in the Limes Field, (2) granted the Bennett Unit a production allowable equal to that which would be granted

130. *Hayes*, 809 S.W.2d at 659 (citing *Armbruster v. Thetis Energy Corp.*, 675 P.2d 476 (Okla. App. 1983); *Mobil Oil Corp. v. Flag-Redfern Oil Co.*, 522 P.2d 651 (Okla. App. 1973)).

131. *Hayes*, 809 S.W.2d at 659.

132. *Id.* at 660.

133. 817 S.W.2d 36 (Tex. 1991).

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

135. *Pend Oreille*, 817 S.W.2d at 37.

a 325-acre unit in the Limes Field, pending a final order on the application, (3) provided that any allowable increment granted in the order would be rescinded and subject to make-up if the Commission denied Forney's application, (4) ordered that proceeds attributable to the production allowable for acreage in excess of the 266 acres currently assigned to this well be paid into an escrow account, and (5) stated that the interim order would be superseded by entry of the final MIPA order.¹³⁶

In September 1985, the Commission issued an order delineating the productive limits of the Limes Field. The order declared that the Limes Field consists of two separate, non-communicating sands and that the unit well penetrates both sands and causes commingling. The Railroad Commission granted a Rule 10¹³⁷ exception, permitting downhole commingling of the two sands, and established allocations for the Main Sand based on productive net acre-feet, and for the Stray Sand, based on surface acreage. Between the time of the interim order in the MIPA proceeding and the final order in the productive acreage proceeding, Pend Oreille made payments to the escrow account as required by the interim order. However, when the final order in the productive acreage case was issued, Pend Oreille ceased making the escrow payments.

In August 1987, the Commission entered a final MIPA order, pooling productive acreage for the Bennett Unit and Forney tracts as to both the Main and the Stray Sands. This order was made effective as of May 7, 1984, the date of the MIPA interim order. Pend Oreille appealed to the district court, which affirmed, and to the court of appeals, which affirmed in part and reversed in part the trial court's judgment.¹³⁸ Pend Oreille, Forney, and the Commission appealed to the Texas supreme court.

On appeal, the supreme court first addressed whether Forney's offer to voluntarily pool was fair and reasonable.¹³⁹ The Commission has authority

136. *Id.* at 38-39.

137. Tex. R.R. Comm'n, 16 TEX. ADMIN. CODE § 3.10(b) (West Sept. 1, 1988). The exception was designed to prevent waste, promote conservation, and protect correlative rights. 817 S.W.2d at 45.

138. Railroad Commission of Texas v. Pend Oreille Oil & Gas Co., Inc., 788 S.W.2d 878 (Tex. App.—Corpus Christi 1990), *aff'd in part, rev'd in part*, 817 S.W.2d 36 (Tex. 1991).

139. *Pend Oreille*, 817 S.W.2d at 39-40. Prior to discussing the fairness and reasonableness of Forney's offer, the supreme court clarified the appropriate appellate standard of review. The court distinguished its decision in *Carson v. Railroad Comm'n*, 669 S.W.2d 315 (Tex. 1984), where the court held that the proper review of whether an offer is fair and reasonable is a "jurisdictional review" rather than a substantial evidence review under the Administrative Procedure & Texas Register Act § 19(e)(5), TEX. REV. CIV. STAT. ANN. art. 6252-13a § 191(e)(5) (Vernon Supp. 1992). A substantial evidence review requires reversal of agency action if substantial rights of the appellant are prejudiced by administrative findings, inferences, conclusions, or decisions that are "not reasonably supported by substantial evidence in view of the reliable and probative evidence in the record as a whole." *Id.* The court explained that in *Carson*, the court of appeals was held to have misinterpreted MIPA § 102.013(c), and the court of appeals' application of such section was found by the Texas Supreme Court in *Carson* to be erroneous as a matter of law. 817 S.W.2d at 41; 669 S.W.2d at 316. Thus, in that case, the court was deciding the question of the Commission's jurisdiction, as a matter of law, and was therefore not required to scrutinize the administrative record to determine whether there was substantial evidence to support the Commission's conclusion. The Texas supreme

to order pooling when the owners have not agreed to pool their interest¹⁴⁰ only after a fair and reasonable offer to pool has been made voluntarily.¹⁴¹ In this regard, the court determined that there was substantial evidence to support the Commission's conclusion that Forney's offer of voluntary poolings was fair and reasonable.¹⁴² Forney's offer was detailed and contained several alternatives. The court also noted that Pend Oreille did not respond to Forney's offer by counteroffer,¹⁴³ and such lack of response frustrated the goal of MIPA, that of encouraging voluntary pooling.¹⁴⁴ Although a counteroffer is not required by MIPA, the court stated that the absence of a counteroffer is a factor to be considered in deciding if an offer is fair and reasonable.¹⁴⁵

The court then addressed the matter of the Commission's authority to force pool, in a single MIPA proceeding, separate deposits of gas that are not in actual communication, but in man-made communication through a wellbore. Pend Oreille claimed that the Commission had no authority to pool the Main Sand and the Stray Sand in one proceeding because MIPA only authorizes the Commission to pool separate tracts of land that "are embraced in a common reservoir of oil or gas"¹⁴⁶ and contended that this statutory authorization was intended to apply only to reservoirs in natural communication. Forney and the Commission, on the other hand, asserted that the MIPA authorized the Commission to pool separate lenticular reservoirs as a "common reservoir" where a common wellbore penetrated both reservoirs and caused downhole commingling. The court of appeals had previously held that the Commission had exceeded its statutory authority in the case in ordering pooling of the two reservoirs at issue because they were not in natural communication.¹⁴⁷ The supreme court, however, reversed based upon its analysis of the evolution of the Commission's authority to authorize commingling.¹⁴⁸

As matters stood in 1977, the court noted that the Commission's State-wide Rule 10 totally prohibited downhole commingling.¹⁴⁹ Following decisions of the Texas Supreme Court in *Railroad Commission of Texas v. Graford Oil Corp.*¹⁵⁰ and *Gage v. Railroad Commission of Texas*,¹⁵¹ which confirmed the Commission's lack of authority to combine separate reservoirs into a single field for administrative purposes, the Commission began denying requests for commingling, which had the effect of preventing the recov-

court limited its statement about "jurisdictional review" in the *Carson* case to the narrow issue presented in that case. 817 S.W.2d at 41-42.

140. TEX. NAT. RES. CODE ANN. § 102.011 (Vernon 1978).

141. *Id.* § 102.013.

142. *Pend Oreille*, 817 S.W.2d at 43.

143. *Id.*

144. *Id.*

145. *Id.*

146. *See* TEX. NAT. RES. CODE ANN. § 102.011 (Vernon 1978).

147. 788 S.W.2d at 883.

148. 817 S.W.2d at 44.

149. *Id.* at 45.

150. 557 S.W.2d 946 (Tex. 1977).

151. 582 S.W.2d 410 (Tex. 1979).

ery of reserves in certain lenticular reservoirs.¹⁵² In response, the Texas legislature amended the Natural Resources Code to grant the Commission authority to allow commingling in certain cases in order to prevent waste, promote conservation, and protect correlative rights.¹⁵³

After the passage of such legislation, the Commission amended Statewide Rule 10 to permit exceptions from the rule and in the process further amended Rule 10 to provide that commingled production "shall be considered production from a common source of supply for purposes of proration and allocation." ¹⁵⁴ Subsequently, the Austin court of appeals held that the latter amendment of Rule 10 by the Commission was invalid, reasoning that while the legislature had given the Commission 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.¹⁵⁵ In response to this court decision, the legislature acted again and this time granted the Commission the authority to prorate the production from commingled reservoirs as if they were from a common source of supply.¹⁵⁶

The supreme court considered this legislative history to demonstrate an intent by the legislature for the Commission to have broad discretion in regulating commingled oil and gas, and this discretion included the power to order pooling of reservoirs commingled downhole.¹⁵⁷ According to the court, the legislature's response to *Gage* and *Mote* demonstrates that the legislature resisted an interpretation of the term "common reservoir" that would have limited the Commission's regulatory authority in this area.¹⁵⁸

Of further significance to the supreme court were certain provisions of the Natural Resources Code.¹⁵⁹ The court interpreted sections 86.081(b),¹⁶⁰ 85.046(b), and 86.012(b)¹⁶¹ to evidence the legislature's intent to grant broad

152. 817 S.W.2d at 45.

153. *Id.*; see Act of May 29, 1979, 66th Leg., R.S., ch. 300, §§ 1, 2, 1979 Tex. Gen. Laws 673, 673-75 (codified at TEX. NAT. RES. CODE ANN. §§ 85.046, 86.012).

154. 817 S.W.2d at 45 (quoting Tex. R.R. Comm'n, 4 Tex. Reg. 3082 (1979) (codified at 16 TEX. ADMIN. CODE § 3.10(b), (c) (West Sept. 1, 1988))).

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

156. 817 S.W.2d at 46. See Act of June 16, 1981, 67th Leg., R.S., ch. 688, §§ 1-3, 1981, Tex. Gen. Laws 2578, 2578-80 (codified at TEX. NAT. RES. CODE ANN. §§ 85.053, 85.055, 86.081 (Vernon Supp. 1992)).

157. 817 S.W.2d at 46.

158. *Id.*

159. TEX. NAT. RES. CODE ANN. §§ 86.081(b), 85.046(b), 86.012(b) (Vernon Supp. 1992).

160. Section 86.081(b) provides in part:

When . . . the Commission has permitted production by commingling oil or gas or oil and gas from multiple stratigraphic or lenticular accumulations of oil or gas or oil and gas, the commission may prorate, allocate, and regulate the production of such commingled, separate multiple stratigraphic or lenticular accumulations of oil or gas or oil and gas as if they were a single common reservoir

....

TEX. NAT. RES. CODE ANN. § 86.081(b) (Vernon Supp. 1992).

161. Sections 85.046(b) and 86.012(b) provide:

Notwithstanding the provisions contained in this section or elsewhere in this code or in other statutes or laws, the commission may permit production by

authority to the Commission over gas production from commingled reservoirs.¹⁶² Reasoning that the stated objectives of these sections are virtually identical to the stated purpose of the MIPA, the court concluded that the Commission, in exercising its pooling authority, may permit commingling of separate gas reservoirs not in natural communication in order to achieve the stated statutory objectives.¹⁶³ The court held that the Commission's application of the term "common reservoir" to include the Main Sand and the Stray Sand was reasonable.¹⁶⁴

Finally, the court addressed the validity of the Commission's action in making the MIPA order retroactive and determined that Pend Oreille was estopped from complaining about the retroactive effective date of the final MIPA order.¹⁶⁵ The court found that the parties were on notice that the Commission was contemplating the entry of a pooling order and that the date of the final order would be made effective as of the date of the interim order.¹⁶⁶ Because Pend Oreille initially agreed to this, and because Pend Oreille did not seek a modification of the interim order, the court held that Pend Oreille was precluded from complaining on appeal about the effective date.¹⁶⁷

B. Compliance with Lease Provisions

*Pampell Interests, Inc. v. Wolle*¹⁶⁸ illustrates the requirement for valid pooling that the lessee strictly comply with the lease's pooling provisions. In 1983, Wayne Wolle and others granted an oil, gas, and mineral lease to Pampell Interests, Inc. The lease contained a pooling provision which authorized Pampell to pool the leased premises with other land. The lease further provided that operations on acreage pooled with the Wolle tract would maintain the Pampell lease. On the last day of the primary term of the lease, Zeal Energy Corporation¹⁶⁹ filed a unit designation which purported to pool a portion of the Wolle tract into a 160 acre unit. At that time, Zeal was engaged in drilling operations on other acreage covered by the unit designation. Pampell claimed that its lease covering the Wolle tract was still in force and effect as a result of operations by Zeal on the pooled acreage. The Wolles, on the other hand, contended that the lease had expired, and they soon granted a lease to a third party, U.S. Companies, Inc.

commingling oil or gas or oil and gas from multiple stratigraphic or lenticular accumulations of oil or gas or oil and gas where the commission, after notice and hearing, has found that producing oil or gas and oil and gas in a commingled state will prevent waste, promote conservation, or protect correlative rights.

TEX. NAT. RES. CODE ANN. §§ 85.046(b), 86.012(b) (Vernon Supp. 1992).

162. 817 S.W.2d at 46.

163. *Id.* at 46-47.

164. *Id.* at 47.

165. *Id.* at 48.

166. *Id.*

167. *Id.* at 49.

168. 797 S.W.2d 392 (Tex. App.—Austin 1990, no writ).

169. Alfred E. Pampell is the president and sole shareholder of both Pampell Interests, Inc. and Zeal Energy Corporation. *Id.* at 393.

The Wolles and U.S. Companies brought suit against Pampell and Zeal seeking a declaration that the Pampell lease had expired at the end of its primary term and that the unit designation was void as to the Wolle tract. The Wolles also sought damages. The trial court granted the plaintiffs the declaratory relief they sought and awarded them approximately \$75,000 actual and punitive damages for slander of title.¹⁷⁰ Zeal and Pampell appealed.

Pampell claimed that the unit designation was valid because Zeal was acting as its agent when it filed the document. The appellate court rejected this contention.¹⁷¹ The court noted that the parties to an oil, gas, and mineral lease, who attempt to utilize a pooling provision therein, must strictly comply with the requirements of such provision.¹⁷² The particular pooling provision at issue required the "lessee" to execute and record the unit designation.¹⁷³ Accordingly, Pampell was the party required to sign and file the document, not Zeal.¹⁷⁴ Therefore, Pampell failed to strictly comply with the lease provision.¹⁷⁵ As to the issue of agency, the court noted that Zeal did not specify in the unit designation that it was acting as agent for Pampell.¹⁷⁶ To the contrary, Zeal purported to be the owner of the Pampell lease.¹⁷⁷ The appellate court therefore affirmed the trial court's judgment voiding the lease and the unit designation with regard to the lease.¹⁷⁸

The court of appeals, however, reversed the trial court's award of damages, noting that a plaintiff who sues for slander of title must plead and prove the loss of a specific sale.¹⁷⁹ The plaintiffs in the case at hand alleged a cloud on their title and general damages. Because the plaintiffs failed to allege the loss of a specific sale, the appellate court reversed the damage award and rendered judgment that the Wolles take nothing on their claim for slander of title.¹⁸⁰

IV. ISSUES INVOLVING AGENCY REGULATION

In *Lone Star Salt Water Disposal Co. v. Railroad Commission*¹⁸¹ the court of appeals affirmed the trial court's judgment upholding a 1979 Railroad Commission order requiring Lone Star to clean, back-fill, and compact three pits filled with oil and saltwater residue, and to dispose of the oil and residue.¹⁸² The pits, which had been part of an oil skimming plant established in the 1920s in the Spindletop field, were part of an extensive network of

170. *Id.*

171. *Id.* at 394.

172. *Id.*

173. *Id.*

174. *Id.*

175. *Id.*

176. *Id.*

177. *Id.*

178. *Id.* at 396.

179. *Id.* at 395.

180. *Id.* at 396.

181. 800 S.W.2d 924 (Tex. App.—Austin 1990, no writ).

182. *Id.* at 931.

canals through which saltwater and waste oil was channeled to the plant. After recoverable oil was skimmed from the surface, the remaining saltwater and oil mixture was pumped into the three disposal pits. While in these pits, the oil and saltwater would separate and the saltwater would be pumped out of the pits for disposal into a local river. The oil residue, or sludge, that remained in the pits was ignited, and most, but not all of it, burned away. Over the years, a substantial amount of sludge accumulated in the pits. These pits were originally owned and operated by Yount-Lee Oil Company, which merged into Stanolind Oil Company (now Amoco) in 1935. Stanolind operated the skimming facility from 1935 until 1952, when it conveyed the system to Lone Star. Lone Star operated the skimming plant until 1975.

In 1978, the Commission issued a notice to Lone Star and Amoco of a hearing to consider responsibility for proper disposal of the sludge¹⁸³ in the three pits and for backfilling and compacting the pits.¹⁸⁴ The Commission ultimately ordered Lone Star to dispose of the sludge and to fill the pits. Lone Star appealed, claiming that Amoco should be ordered to share the responsibility and expense of the clean-up work.

On appeal, Lone Star claimed that the Commission's order was not supported by substantial evidence and was arbitrary and capricious. With regard to the matter of substantial evidence, Lone Star asserted that the basic facts found by the Commission were not used to support its determination that Lone Star should be wholly responsible for the clean-up operations because it exercised control over the skimming system and the pits for twenty-three years, from 1952 to 1975. Lone Star argued that because the Commission found that Amoco had also stored sludge in the pits, the Commission was compelled to order Amoco to bear partial responsibility for the clean-up. The court of appeals, however, disagreed, holding that reasonable minds could have reached the same conclusion that the Commission reached, and that there was no authority requiring the Commission to order both parties to clean the pits and backfill them.¹⁸⁵

As to Lone Star's claim that the Commission's order was arbitrary and capricious, Lone Star contended that the Commission abused its discretion by considering irrelevant factors. According to Lone Star, the only relevant factor was whether a party stored petroleum by-products in an open pit, and the selection of only one party (Lone-Star) who partially contributed to an indivisible condition (the pits) to bear total responsibility for that condition was inherently arbitrary. The appellate court rejected this claim, analogiz-

183. Statewide Rule 21(C) provides: "No person engaged in the production, transportation, storage, handling, refining, reclaiming, processing, treating, or marketing of crude petroleum oil or the products or lay products thereof shall store, either permanently or temporarily, crude petroleum oil or the products and by products thereof in open pits or earthen storage." *Tex. R.R. Comm'n*, 16 *TEX. ADMIN. CODE* § 3.21(c) (West 1988).

184. Statewide Rule 8(C)(4), as it existed at the time of the Commission's order, provided: "In any instance where a salt water disposal pit is presently in use and is abandoned, due to cessation of flow of salt water thereto, whether voluntary or mandatory, such pit shall be backfilled and compacted." *Texas R.R. Comm'n. Rule 8(C)(4)* (since revised as 16 *TEX. ADMIN. CODE* § 3.8 (West 1988)).

185. 800 S.W.2d at 929.

ing this case to tort law situations in which an injured plaintiff who suffered an indivisible harm caused by two or more tortfeasors may proceed against only one of them for total relief.¹⁸⁶ Accordingly, the court of appeals affirmed the trial court's judgment which upheld the Commission's order.¹⁸⁷

The court of appeals in *Lone Star Gas Co. v. Railroad Commission*¹⁸⁸ reversed the judgment of the trial court, and invalidated Rules 30¹⁸⁹ and 34¹⁹⁰ of the Texas Railroad Commission, which regulate the purchase of gas by pipeline affiliates known as "special marketing programs" (SMPs)¹⁹¹ on the basis that the Rules attempt to regulate a subject which has been preempted by federal law. In response to the creation of SMPs, the Commission promulgated rules under which it established a scheme that makes its "rata-ble take" and proration rules applicable to the SMPs.¹⁹²

The evidence presented in this case established that Lone Star is an intra-state and interstate pipeline company wholly owned by Enserch Corporation and that Enserch Gas Company (EGC) is an affiliated gas marketing company that purchases gas from the spot market and delivers that gas to customers by utilizing Lone Star's pipeline system. The evidence further established that EGC often purchases gas from operators who have contracts with Lone Star and in such situations Lone Star conditions the release of gas from its contracts for sale to EGC upon an agreement from the operator that gas sold to EGC will be credited to Lone Star's take obligation under the contract from which the gas is being released.

Rules 30 and 34 created obvious complications for the release procedures being followed by Lone Star and EGC, and, as a result, Lone Star and EGC filed suit seeking a declaration that Rules 30 and 34 were invalid as applied

186. *Id.* at 930.

187. *Id.* at 931.

188. 798 S.W.2d 888 (Tex. App.—Austin 1990, writ granted).

189. Tex. R.R. Comm'n, 16 TEX. ADMIN. CODE § 3.30 (West 1988).

190. *Id.* § 3.34.

191. Special marketing programs are affiliates of gas pipeline companies created primarily for the purpose of purchasing gas that has been released from long-term gas purchase contracts under which the pipeline is committed to buy the gas. 798 S.W.2d at 891.

192. One of the rules promulgated by the Commission in this respect is Rule 30(a)(1) which provides in relevant part that "[a] first purchaser and any affiliate of the purchaser that transports any natural gas it purchases from a well by use of the same pipeline system used by the first purchaser of which it is an affiliate shall be treated as a single first purchaser for purposes of ratability requirements." Tex. R.R. Comm'n, 16 TEX. ADMIN. CODE § 3.30(a)(b) (West 1988). An affiliate is defined as a "person or entity that owns, is owned by, or is under common ownership with another person or entity to the extent of 50% or more or that otherwise controls or is controlled by another person or entity." *Id.* § 3.30(a)(5). An exception from the scope of Rule 30 is created for entities which qualify as SMPs under Rule 34(h). Rule 34(h) establishes a regulatory scheme by which a pipeline may qualify an affiliate as an SMP and the SMP will then be considered a separate first purchaser not subject to the aggregation requirements of Rule 30. *Id.* § 3.34(h). Rule 34, however, imposes stringent requirements upon those seeking to qualify as an SMP including the following: (i) every offer of purchase made by the SMP must be made to all operators on the affiliate pipeline's system from whom the pipeline is buying gas; (ii) the SMP and its affiliated pipeline are prohibited from seeking significant take-or-pay price concessions in conjunction with the release of gas by the pipeline and its subsequent purchase by the SMP; and (iii) the SMP and its affiliate pipeline are prohibited from purchasing low-cost, low-priority gas until all high-cost, high-priority gas on the affiliate pipelines system is purchased. *Id.*

to Lone Star's intrastate pipeline system. Lone Star and EGC advanced several arguments to support the claim that the rules are invalid. The court of appeals first addressed the contention of Lone Star and EGC that Rules 30 and 34 exceed the Commission's statutory rule-making authority. In this regard, the court noted that the Commission's statutory authority is derived from a broad legislative delegation of authority codified in the Texas Natural Resources Code¹⁹³ which authorizes the Commission in administering the provisions of the Code to adopt any rule or order in the manner provided by law that it finds necessary to effectuate the provisions and purposes of the Code.¹⁹⁴ Specifically, the court observed that the Commission has the authority and the duty to promulgate rules for the prevention of waste and conservation of gas.¹⁹⁵ The court found that the Commission had promulgated Rules 30 and 34 as part of an effort to protect priority schemes created by the Commission concerning nominations, purchases, and the production of gas following the advent of SMPs, and that the priority schemes at issue assured that casinghead gas, oil, and gas being produced from special allowable wells would continue to be produced.¹⁹⁶ On this basis, the court concluded that Rules 30 and 34 enhanced the Commission's ability to regulate waste, promote conservation, protect correlative rights, and prevent discrimination, all of which provided ample authority for the Commission to promulgate those rules.¹⁹⁷

The court next addressed the claim of Lone Star and EGC that Rules 30 and 34 are inconsistent with the provisions of the statutes that create the Commission's rule-making authority. The court rejected this contention as well, holding that Rules 30 and 34 are consistent with the underlying statutes and their goals of preventing waste, protecting correlative rights, and preventing discrimination.¹⁹⁸ In this connection, the court stated that the Commission had demonstrated that in the absence of Rules 30 and 34 the protective scheme created by the Commission to effectuate those goals would be circumvented.¹⁹⁹

The court next considered the contention of Lone Star and EGC that the statutes on which the Commission relied in promulgating Rules 30 and 34 do not contain standards supporting the Commission's exercise of its rule-making authority in this instance. Specifically, Lone Star and EGC complained that the statutes involved do not define the term "affiliate," and do not contain authorization for aggregating affiliates and treating them as a single first purchaser and do not define the concept of discrimination to encompass the content of contractual negotiations. The court of appeals summarily rejected these arguments stating that the legislature's failure to address specific unforeseen circumstances in statutes that delegate authority

193. 798 S.W.2d at 893.

194. *Id.* (citing TEX. NAT. RES. CODE ANN. § 86.041 (Vernon 1978)).

195. *Id.*

196. *Id.*

197. *Id.* at 893-94.

198. *Id.*

199. *Id.*

to the Commission does not render those statutes invalid for "want of standards."²⁰⁰ The court further noted that to require that legislation address each possible exercise of Commission power would defeat the purpose of delegating legislative authority to the Commission for rule-making purposes.²⁰¹ The court concluded that the standards necessary to support the action of the Commission and promulgating Rules 30 and 34 are found in those statutes that direct the Commission to prevent waste, promote conservation, and protect correlative rights.²⁰²

Finally, the court addressed whether Rules 30 and 34 attempted to regulate an area which was preempted by federal statute. In this regard, Lone Star and EGC contended that the rules were preempted by the Natural Gas Act (NGA)²⁰³ and the Natural Gas Policy Act of 1978 (NGPA).²⁰⁴ The NGA established a price control system to regulate the transportation and sale of gas in interstate commerce.²⁰⁵ The NGPA was enacted after the energy shortages of the 1970s and was generally intended to permit the phased deregulation of natural gas price controls.²⁰⁶ In the process of doing this, however, the NGPA actually expanded federal control of the gas industry in many respects by delegating regulatory authority over intrastate transactions to the Federal Energy Regulatory Commission while preserving the NGA pricing control of gas flowing in interstate commerce.²⁰⁷ In analyzing the preemption issue, the court of appeals noted that the United States Supreme Court specifically held that under the NGA state regulation of gas purchasers is completely preempted and any attempt by a state to regulate gas purchasers is void.²⁰⁸ The court also noted that the United States Supreme Court has consistently held that the NGPA preempts state attempts to regulate gas prices by regulating natural gas purchasers.²⁰⁹

Recognizing that states may regulate production in a manner that incidentally affects purchasers' costs, the court of appeals concluded that under the decision in *Transcontinental Gas Pipeline Corp. v. State Oil & Gas Board of Mississippi*²¹⁰ the NGPA preempts all state regulations that have an impact on matters within federal control and that are not an incident of efforts to achieve a "proper state purpose."²¹¹ To determine whether a particular state regulation is intruding upon federally preempted ground, the court stated that the *Transco* decision requires a determination of three factors:

200. *Id.*

201. *Id.*

202. *Id.*

203. 15 U.S.C.A. §§ 717-717W (West 1976 & Supp. 1990).

204. 15 U.S.C.A. §§ 3301-3432 (West 1982 & Supp. 1990).

205. 798 S.W.2d at 895.

206. *Id.*

207. *Id.* at 895-96.

208. *Id.* at 896 (citing *Northwest Cent. Pipeline Corp. v. State Corp. Comm'n of Kan.*, 489 U.S. 493 (1989)).

209. *Id.* (citing *Transcontinental Gas Pipeline Corp. v. State Oil & Gas Bd. of Miss.*, 474 U.S. 409 (1986); *Northwest Pipeline*, 489 U.S. 493 (1989); *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293 (1988)).

210. 474 U.S. 409 (1986).

211. 798 S.W.2d at 896 (quoting *Northwest Pipeline*, 189 S.Ct. at 1277).

“(1) whether the regulation comes within the limits of the comprehensive federal regulatory scheme; (2) whether the state regulation conflicts with the federal interest, expressed by [the NGA and the NGPA], in protecting gas consumers by ensuring low gas prices; and (3) whether the regulation is directed at purchasers.”²¹²

Applying these standards to the case at hand, the court determined that Rules 30 and 34 violated these standards.²¹³ The court determined that the Rules, as applied in this case, impermissibly regulated federally regulated purchasers of gas.²¹⁴ Lone Star is a federally regulated purchaser of gas, because it is a pipeline that sells to both interstate pipelines and to local distribution companies served by interstate pipelines.²¹⁵ EGC, although not directly regulated by federal legislation, nevertheless is also a federally regulated purchaser of gas because it purchases gas in a market that is partially regulated.²¹⁶ As a result, the court concluded that Rules 30 and 34 encroached upon the federally preempted field established by the NGA and the NGPA.²¹⁷ Further, the court held that although Rules 30 and 34 affect production and therefore appear to fall within the permissible state regulation,²¹⁸ in reality the Rules also create higher gas prices on the spot markets in which SMPs operate.²¹⁹ Therefore the Rules constitute an exercise of state regulatory authority for an improper purpose in that they regulate gas pricing that falls within the federal regulatory scheme.²²⁰

Finally, the court analyzed the effect of Rules 30 and 34 upon gas supply and prices. Because Rule 30 aggregates an SMP and its affiliated pipeline into a single first purchaser, if the SMP transports any gas it purchases on the affiliate's pipeline, the court concluded that the consequence for EGC is that its ability to buy low-cost spot market gas for which it has willing buyers is limited to the affiliated pipeline's ability to buy high-cost gas for which no market exists.²²¹ The only alternative is for EGC to qualify under Rule 34, in which case (i) every offer to purchase gas made by EGC must be made to all operators on the affiliated pipeline's system from which the pipeline has been buying gas; (ii) the SMP and its pipeline affiliate are both prohibited from seeking significant take-or-pay price concessions; and (iii) the SMP and its pipeline affiliate are prohibited from buying low-cost, low-priority gas until all high-cost, high-priority gas on the system is purchased.²²² The court concluded that although these rules do not specifically restrict the SMP's ability to purchase gas, they effectively constitute a prohibition against a significant amount of otherwise permissible natural gas purchases

212. *Id.* (citing *Transco*, 474 U.S. at 420).

213. *Id.* at 897.

214. *Id.*

215. *Id.* at 896.

216. *Id.*

217. *Id.* at 897.

218. *Id.* at 896.

219. *Id.* at 896-97.

220. *Id.* at 897.

221. *Id.*

222. *Id.*

and this has a substantial affect upon gas supply and gas pricing.²²³ On this basis the court concluded that Rules 30 and 34 fall within the limits of the comprehensive federal scheme which regulates the price of natural gas, conflict with the federal interest in maintaining low gas prices, and seeks to regulate gas purchasers already regulated by federal statute.²²⁴ As a result, the court concluded that Rules 30 and 34 impermissibly intruded upon subject areas preempted by federal statutes.²²⁵

In *Texaco Producing, Inc. v. Fortson Oil Co.*²²⁶ the court of appeals reversed the trial court's judgment affirming the Railroad Commission's denial of Texaco's conditional application for reinstatement of unused allowables²²⁷ on the ground that the Commission's actions were not supported by substantial evidence and were arbitrary and capricious.²²⁸ In this case, Texaco and Fortson were the only producers in the two reservoirs involved. Texaco and Fortson sold their gas to the same purchaser, and the gas was transported by the same pipeline. In 1987 and 1988, Fortson's and Texaco's actual production from the reservoirs was significantly lower than their per well allowables because their purchaser took less gas than Texaco and Fortson could have produced. Texaco's and Fortson's unused allowables were automatically canceled pursuant to the Commission's rules. In 1989, when demand for gas increased, Fortson applied to the Commission for reinstatement of its canceled allowables. Texaco filed a conditional application for reinstatement of its canceled allowables if Fortson's application was granted. The Commission granted Fortson's application, and denied Texaco's. Texaco appealed.

It was undisputed that reinstatement of Fortson's canceled allowables would result in drainage that Texaco would be unable to offset. However, the Commission and Fortson argued that the Commission was justified in treating Fortson and Texaco differently for several reasons. First, Fortson and the Commission contended that the Commission was absolutely precluded from reinstating Texaco's allowables because Texaco's canceled allowables were for "limited" wells,²²⁹ whereas Fortson's reinstated allowables were for "prorated" wells.²³⁰ Because Statewide Rule 31(g)(1)²³¹ expressly provides that limited wells are not allowed to accumulate underproduction, Fortson and the Commission claimed that this rule prevented reinstatement of Texaco's canceled allowables. The court of appeals rejected this contention, noting that Texaco's application for reinstatement was brought under

223. *Id.*

224. *Id.* at 898.

225. *Id.*

226. 798 S.W.2d 622 (Tex. App.—Austin 1990, no writ).

227. "An 'allowable' is the amount of gas a reservoir or a well is permitted to produce under the commission's proration orders." *Id.* at 623.

228. *Id.* at 626.

229. Limited wells are not capable of producing to the full extent of their prorated allowables, so they are assigned limited allowables based on their limited production capability. Tex. R.R. Comm'n, 16 TEX. ADMIN. CODE § 3.31(f)(1) (West Supp. 1990).

230. Prorated wells are those that are capable of full production, and they are assigned a pro rata share of the reservoir's total allowable. *Id.* § 3.31(f)(4).

231. *Id.* § 3.31(g)(1).

Rule 34(k),²³² which expressly provides for an exception to Rule 31 to protect correlative rights and to prevent undue hardship. According to the court of appeals, the distinction between prorated and limited wells is a distinction without a difference when the Commission is proceeding to protect correlative rights.²³³ Accordingly, the court held that the distinction between limited wells and prorated wells would not support the Commission's different treatment of Fortson and Texaco.²³⁴

Second, Fortson claimed that its drainage of Texaco would not injure Texaco's correlative rights because Texaco had already produced more than its share of reserves from the field involved. Originally, allowables for the field at issue had been assigned on the basis of surface acreage. Later, the Commission changed the field allowable formula to an acre-feet basis. As a result of this change, Fortson's share of production was increased. Fortson contended that, had the acre-feet formula been applicable as of the date of first production from the field, Fortson would have been entitled to a produce greater share of the field's reserves, and under this reasoning, Texaco had already overproduced its fair share of the reservoir. The court, however, also rejected this claim, reasoning that Texaco's advantage did not result from illegal activity; rather, Texaco's "overproduction" had occurred as the result of compliance with the Commission's previous field allowable orders.²³⁵ The court also rejected Fortson's argument because the Commission's orders may not be made to operate retroactively, and accepting Fortson's position necessarily would cause the Commission to effectively apply its field allowable order retroactively to correct past infringements of correlative rights.²³⁶

Third, Fortson and the Commission asserted that Texaco failed to meet its burden of showing hardship because Texaco's application was purely speculative since Texaco would suffer hardship only if Fortson produced from the field at the level of its reinstated allowables. The court disagreed with this contention, holding that the contingent nature of Texaco's application did not make it impossible for the Commission to decide the issue.²³⁷ The court of appeals accordingly reversed the district court's judgment affirming the Commission, and remanded the case to the Commission for further proceedings.²³⁸

V. ISSUES INVOLVING JOINT OPERATIONS

*Pelto Oil Co. v. CSX Oil & Gas Corp.*²³⁹ involved claims between two working interest owners over proceeds from the sale of gas that was misallocated by the operator. Pelto and CSX are working interest co-owners, with

232. *Id.* § 3.34(k) (West 1988).

233. 798 S.W.2d at 624.

234. *Id.* at 625.

235. *Id.*

236. *Id.*

237. *Id.* at 626.

238. *Id.*

239. 804 S.W.2d 583 (Tex. App.—Houston [1st Dist.] 1991, writ denied).

others, in offshore oil and gas leases covered by the Ship Shoal Block 271 Unit. The operator of the unit is CNG Producing Company. The owners are parties to a unit operating agreement and a gas balancing agreement. For a fourteen month period, Pelto's share of the gas produced from the unit was sold to Texas Gas, but was mistakenly allocated by CNG to CSX. Texas Gas, therefore, paid CSX for the gas that should have been allocated to Pelto.

Pelto brought suit against CSX seeking to recover the proceeds that were paid to CSX by Texas Gas under the erroneous allocation. Pelto claimed that CSX breached the unit operating agreement.²⁴⁰ Pelto asserted that, by retaining the proceeds for gas that should have been allocated to Pelto, CSX wrongfully marketed Pelto's interest in production. CSX defended the action on the grounds that the gas balancing agreement provided for in-kind balancing as the exclusive remedy in situations of overproduction and underproduction. Both parties moved for summary judgment. The trial court granted CSX's motion, and denied Pelto's.²⁴¹ Pelto appealed.

In response to CSX's claim that the gas balancing agreement provided for the exclusive remedy of in-kind balancing, Pelto contended that the gas balancing agreement did not apply to all gas imbalances, and, specifically, did not apply to imbalances due to accounting errors. The appellate court agreed. The court first noted that the gas balancing agreement did not contain any express statement that it was the sole and exclusive remedy in the event gas production accounts became imbalanced.²⁴² Turning to the preamble of the gas balancing agreement, the court observed that, by its express language, the gas balancing agreement was intended to apply to those situations when one or more of the parties "may be unable to take or market its interest in the gas production from time to time."²⁴³ In the case at hand, the court found that Pelto was able to take its share of gas, and Pelto had marketed its share to Texas Gas.²⁴⁴ The appellate court held that the term "may be unable to take or market" did not include situations, like the one at hand, where there was a failure to credit a working interest owner for its share of production, which had actually been taken and marketed, but for which the working interest owner was not credited, due to the operator's accounting error.²⁴⁵ Accordingly, the court determined that the gas balancing agreement did not apply to the matter at issue.²⁴⁶

The court next considered whether CSX breached the marketing provi-

240. The agreement provided, in part:

"[E]ach party shall have the sole and exclusive right to direct and effect the sale and disposition of its respective interest in such production. Under no circumstances shall any party hereto have the right to market any other party's interest in production"

Id. at 584 (emphasis omitted).

241. *Id.* at 586.

242. *Id.* at 586-87.

243. *Id.* at 587.

244. *Id.*

245. *Id.*

246. *Id.*

sion of the operating agreement. CSX claimed that, if there was any breach of the operating agreement, then it was a breach by CNG, the unit operator. Additionally, CSX asserted that it only marketed its own share of production when Pelto's agent, CNG, failed to deliver Pelto's share of production, and that Pelto was bound by the acts of its agent. The court rejected this argument, noting that CNG was also the agent of CSX, who was likewise bound by CNG's acts and further noting that all working interest owners received copies of the monthly allocation reports, and all were equally charged with knowledge of allocation errors.²⁴⁷ On these facts, the court held that CSX breached the unit operating agreement when it failed to deliver to Pelto the proceeds received by CSX for sales of gas that should have been allocated to Pelto,²⁴⁸ and reversed the trial court's summary judgment.²⁴⁹

In *Texstar North America, Inc. v. Ladd Petroleum Corp.*²⁵⁰ the court of appeals held that the refusal of a non-operator to consent to fracture stimulate a well did not constitute a breach of the applicable joint operating agreement, even though the non-consenting party's activities on adjacent acreage were causing the jointly-owned well to be drained of hydrocarbons. In this case, Ladd owned leases covering an undivided 8.15625% interest in minerals in certain land known as the Zalman Tract. Texstar had leases covering virtually all of the remaining interest in such tract. Ladd also had the majority interest in other leases on lands adjoining the Zalman Tract, and Ladd had established production on these leases. In early 1987, Texstar drilled and completed a producing well on the Zalman Tract as an offset to Ladd's wells. The well, called the Zalman No. 1, was drilled without the consent of, or participation by, Ladd. Ladd, as a non-consenting cotenant, was entitled to share in the revenue of the Zalman No. 1 after payout. Following payout, Texstar and Ladd entered into a joint operating agreement with regard to the Zalman Tract, with Texstar as the operator.

Approximately two years later, Texstar submitted to Ladd a proposal to fracture stimulate the Zalman No. 1 to enhance the well's productive capacity. At the time of the proposal, the Zalman No. 1 was producing in paying quantities. However, Texstar believed that the existing production rate was insufficient to prevent drainage of the Zalman Tract by Ladd's other wells. Ladd did not consent to the fracture procedure. Texstar brought suit against Ladd, alleging that Ladd's refusal to consent to fracture stimulate the Zalman No. 1 constituted breach of duty of good faith and fair dealing and breach of an implied duty of mutual cooperation arising out of the joint operating agreement. The trial court granted summary judgment for Ladd as to all of Texstar's claims.²⁵¹ On appeal, Texstar claimed that the trial court erred in doing so because the joint operating agreement did not permit Ladd to refuse consent in this situation.

247. *Id.*

248. *Id.*

249. *Id.* at 588.

250. 809 S.W.2d 672 (Tex. App.—Corpus Christi 1991, writ denied).

251. *Id.* at 674.

The appellate court examined the joint operating agreement, and found that it was unambiguous.²⁵² It noted that articles VI.B.1²⁵³ and VII.D.2²⁵⁴ expressly provided terms and conditions that had to be satisfied before a well could be reworked. Because fracture stimulation is considered to be a "re-work" procedure, and because Texstar's proposed stimulation involved a well that was then producing in paying quantities, the court held that Article VII.D.2 controlled.²⁵⁵ Under those circumstances, Texstar could not proceed with fracture stimulation without Ladd's consent. Texstar conceded that the agreement did not expressly impose any restrictions on Ladd's right to refuse consent. However, Texstar argued that Ladd, in this situation, could not properly withhold consent without breaching certain duties allegedly owed to Texstar.

With regard to the alleged duty of good faith and fair dealing, Texstar claimed that the relationship between working interest owners is fiduciary in character, and that such persons owed each other the duty of utmost good faith and fair dealing. The court rejected this claim, noting that there can be no implied covenant as to a matter specifically covered by the written terms of the contract.²⁵⁶ Because the joint operating agreement specifically governed the terms and conditions for reworking the operations, the court held that Texstar's reliance upon an implied duty of good faith and fair dealing was without merit.²⁵⁷ As to the alleged duty of mutual cooperation, the court held that because Articles VI.B.1 and VII.D.2 expressly and unambiguously set out the terms under which a party to the joint operating agreement at issue could withhold consent, there could be no implied covenant to the contrary.²⁵⁸ Accordingly, the court of appeals upheld the trial court's summary judgment favorable to Ladd on Texstar's claims.²⁵⁹

In *REO Industries v. Natural Gas Pipeline Co.*²⁶⁰ the Court of Appeals for the Fifth Circuit affirmed the trial court's summary judgment that a non-

252. *Id.* at 677.

253. Article VI.B.1 provided in part:

Should any party herein desire to drill any well on the Contract Area, or to rework, deepen or plug back a dry hole not then producing in paying quantities, the party desiring to drill, rework, deepen or plug back such a well shall give the other parties written notice of the proposed operation, specifying the work to be performed, the location, proposed depth, objective formation and estimated cost of the operation.

Id. at 675.

254. Article VII.D.2 stated, in part:

Without the consent of all parties, no well shall be reworked or plugged back, except a well reworked or plugged back pursuant to the provisions of Article VI.B.2 of this agreement. Consent to the reworking or plugging back of a well shall include all necessary expenditures in conducting such operations and completing and equipping of such well, including necessary tankage and/or surface facilities.

Id. (emphasis omitted).

255. *Id.* at 677.

256. *See id.* at 678 (citing *Exxon v. Atlantic Richfield Co.*, 678 S.W.2d 944 (Tex. 1984)).

257. *Id.*

258. *Id.*

259. *Id.* at 679.

260. 932 F.2d 447 (5th Cir. 1991).

operator did not breach the terms of a joint operating agreement when it opposed the operator's application for an exception to the applicable spacing rules necessary for the continued operation of a gas well covered by the operating agreement.²⁶¹ REO owned the oil rights, and Natural Gas Pipeline Company (NGPL) owned the gas rights in the same 640 acre tract in the Texas Panhandle. In 1985, REO drilled a well seeking oil, but instead found gas. A 1933 joint operating agreement between the predecessors in interest of REO and NGPL specified that under those circumstances the gas operator would have the right, but not the obligation, to purchase the well. If the gas operator declined to purchase the well, the operating agreement provided that the oil operator would own the well and have the right to operate it for his own use and benefit.

REO offered the gas well to NGPL, but NGPL declined to purchase the well. At that time, NGPL had an existing well on the tract that was producing gas, and according to the Texas Railroad Commission's density rule²⁶² and the applicable field rules,²⁶³ only one gas well was permitted on the tract. Thus, the well was useless to NGPL and to REO unless NGPL plugged its pre-existing well or unless the Railroad Commission granted an exception to its density rule. REO initially applied to the Railroad Commission for such an exception. NGPL opposed the application. REO withdrew its application for exception, and brought suit against NGPL seeking damages for NGPL's alleged breach of the operating agreement by interfering with REO's operations. REO asserted that the operating agreement²⁶⁴ obligated NGPL to refrain from opposing REO's application for density exception, to buy REO's well, or to plug its own well, and consequently forfeit all its rights under its gas lease, in order to permit REO to operate the new gas well.

NGPL and REO filed cross-motions for summary judgment. The trial court granted NGPL's motion, and dismissed REO's claim, determining that: (1) there had been no breach of the operating agreement, because the agreement did not require NGPL to refrain from opposing REO's applications of the Commission, and did not impose an obligation on NGPL to either purchase REO's well or to abandon its leasehold rights by plugging its own well; (2) REO's claims were not ripe because REO had shown no injuries; and (3) even if REO had been injured, NGPL's conduct was not the

261. *Id.* at 455-56.

262. Tex. R.R. Comm'n, 16 TEX. ADMIN. CODE § 3.38 (West 1988 & Supp. 1990-91).

263. Railroad Comm'n of Tex., Oil & Gas Div., Docket No. 108, Special Order No. 10-13,196, Adopting and Promulgating Field Rules to Apply to All Gas Wells Located in the West Sweet and West Sour Areas of the Panhandle Field, Rule 3(a), September 24, 1948; Docket No. 10-87,017, Amended Final Order Adopting and Clarifying Rules and Regulations, March 20, 1989.

264. In support of its position, REO relied upon Paragraph II of the operating agreement, which provides: "[I]t is further understood that each party shall so conduct its operations and so locate its improvements and equipment on said premises as to interfere as little as possible with operations of the other." 932 F.2d at 452 (emphasis omitted). REO also relied upon Paragraph XV of the operating agreement, which states: "Each party agrees . . . to comply with all state and federal laws and to protect any interest of the other party in such leases against liens or encumbrances caused by its acts or omissions." *Id.* (emphasis omitted).

cause of any such damages.²⁶⁵ REO appealed.

REO argued on appeal that when NGPL elected not to purchase the well, the provisions of the operating agreement effectively transferred to REO title to all the gas that the well could produce. As a consequence, REO contended that NGPL forfeited all its rights to the gas in place under the tract. According to REO, NGPL breached the operating agreement when it interfered with REO's efforts to produce the gas by opposing REO's application for an exception to Rule 38 and by failing to plug its own well.

The Fifth Circuit rejected REO's argument. The court held that NGPL had not breached the operating agreement because its provisions specifically stated that it is subject to state statutes and regulations.²⁶⁶ Noting that the Railroad Commission requires notice to interested parties and permits such parties to appear at hearings regarding density exceptions,²⁶⁷ the court concluded that NGPL, in opposing REO's density exception application, was merely exercising the rights granted to it by the Railroad Commission.²⁶⁸ The Fifth Circuit similarly rejected REO's contention that the operating agreement required NGPL to plug its well, holding that paragraphs II and XV could not reasonably be construed to require such results, and that there was nothing in the operating agreement that warranted the implication of such requirements.²⁶⁹

Next, the court considered REO's complaint regarding the district court's holding that REO's claim was not ripe because REO had not suffered any damages. The trial court reasoned that, without an exception to the density rule, REO's well had no economic value.²⁷⁰ The Fifth Circuit agreed with the trial court's analysis that the damages sought by REO were for loss of the economic value of the well, being lost potential profits.²⁷¹ The court reasoned that REO never had any exploitable economic interest in the potential production of the new gas well, because without a density exception, it could not produce a single molecule of gas.²⁷² Because REO could not legally produce gas, the Fifth Circuit concluded that the district court properly held that REO had not suffered any legally cognizable injury.²⁷³

Finally, the appellate court considered REO's complaint regarding the district court's holding that, even if NGPL's actions breached the contract and even if REO suffered damages, REO's damages were not causally related to the breach. The Fifth Circuit agreed that there was no clear causal link between NGPL's actions and any injury on the part of REO, because REO had voluntarily withdrawn its application for density exception, and it was the lack of exception relief that brought about the worthlessness of

265. *Id.* at 452.

266. *Id.* at 455.

267. Tex. R.R. Comm'n, 16 TEX. ADMIN. CODE §§ 3.38(a)(4), 3.38(f), 1.24 (West 1988 & Supp. 1990-91).

268. 932 F.2d at 455.

269. *Id.* at 455-56.

270. *Id.* at 457.

271. *Id.*

272. *Id.*

273. *Id.*

REO's gas well.²⁷⁴ The court therefore affirmed the trial court's summary judgment.²⁷⁵

VI. MISCELLANEOUS ISSUES

*NL Industries, Inc. v. GHR Energy Corp.*²⁷⁶ arose out of a workover agreement between the parties that was entered into in connection with GHR's reorganization under Chapter 11 of the U.S. Bankruptcy Code.²⁷⁷ GHR owned 10 wells in southwest Texas that it desired to have fractured for the purpose of enhancing gas production. NL is an international corporation that provides such services, and the bankruptcy court authorized GHR to enter into a workover agreement with NL in order to generate more income for the bankrupt estate. The agreement provided that NL would service the wells using whatever method GHR stipulated. The agreement also provided that an engineering firm, S.A. Holditch & Associates, Inc., would review GHR's designs. NL was required to finance the workovers, but, as compensation for the services, GHR assigned NL a production payment equal to 75% of the net revenue from the sale of that portion of the gas production attributable to the production enhancement procedures. GHR assured NL that the revenues produced by the workovers would compensate NL within six months for its expenses. As it turned out, however, the workovers cost more than \$14 million, and produced only \$5.4 million in additional revenue.

NL sued GHR under a variety of causes of action, including breach of contract, negligence, fraud and mutual mistake, seeking actual and punitive damages. NL's underlying claim was that GHR used a much riskier and more expensive method to rework the wells than the method NL thought it would use. NL also sued Holditch for damages under a negligence theory, on the claim that the firm had not used reasonable care in reviewing GHR's workover proposals. GHR moved for partial summary judgment with regard to NL's causes of action for breach of contract and negligence. Holditch moved for summary judgment as to all of NL's claims against it. The trial court granted GHR's motion, and dismissed all of NL's claims against GHR, even those not addressed by GHR's motion.²⁷⁸ The court also granted Holditch's motion.²⁷⁹ NL appealed.

NL complained on appeal first that the trial court erred in dismissing NL's fraud and mutual mistake claims against GHR, because GHR's motion was not directed to such claims. The appellate court agreed. The court noted that Federal Rule of Civil Procedure 56(c)²⁸⁰ permits a court to grant summary judgment in favor of a party that did not request it, but only "upon

274. *Id.* at 458.

275. *Id.*

276. 940 F.2d 957 (5th Cir. 1991), *petition for cert. filed*, (U.S. Nov. 1, 1991).

277. 11 U.S.C.A. §§ 1101-1174 (West 1979).

278. 940 F.2d at 963.

279. *Id.*

280. FED. R. CIV. P. 56(c).

proper notice to the adverse party.”²⁸¹ Because NL did not receive notice that the trial court was considering dismissing NL’s fraud and mutual mistake claims against GHR, the court held that the dismissal of those claims was improper, reversing and remanding such causes of action to the trial court.²⁸²

NL next complained of error in the granting of GHR’s motion for summary judgment with regard to its breach of contract claims. NL asserted that GHR breached the workover agreement in three respects: (1) by failing to design the formation stimulation program based upon a model prepared by Holditch; (2) by failing to obtain required economic certifications that the revenue created by the enhancement procedures would exceed the cost of such procedures; and (3) by failing to obtain Holditch’s approval of the design for three of the ten proposed formation stimulation programs. Among other defenses, GHR contended that its contract with NL stated that as for all claims arising under the workover agreement, NL must look exclusively to the incremental net revenue from the wells, and, in the event this revenue is insufficient, that NL would have no recourse against GHR. The court examined the relevant provision and concluded that it was in the nature of a “production payment clause,” which gave NL a share of the minerals produced from the land, but did not prevent NL from recovering damages if GHR breached the contract.²⁸³

The court then addressed NL’s claim that GHR breached the workover agreement by not designing its fracture treatments in a manner consistent with the “Holditch Model.” According to NL, the “Holditch Model” is a concept for fracturing wells, under which the length of the fracture is specifically tailored to the well’s drainage area and reservoir permeability. NL claimed that the fracture treatments designed by GHR did not conform to the Holditch Model in that they were experimental and not individually designed for each particular well. GHR responded that the contract did not refer to any particular Holditch Model and, in any event, the fracture treatments were designed by a computer program developed and sold by Holditch. The appellate court found that the contract provision at issue was ambiguous,²⁸⁴ and that factual issues as to the parties’ intent precluded summary judgment.²⁸⁵

As to NL’s claim that GHR breached the workover agreement by failing to submit three of ten designs to Holditch for review and approval, the court

281. 940 F.2d at 965 (quoting *Celotex Corp. v. Garrett*, 477 U.S. 317, 326 (1986)).

282. *Id.* at 966.

283. *Id.* at 268. In this regard, the court stated:

The owner or operator of a . . . well must protect the interest of the owner of a production payment or an overriding royalty, particularly in a case such as this, in which the entire reimbursement for NL’s services was to come from the production payment. If the owner or operator of the . . . well does something to diminish the value of the mineral interest, the owner of a production payment or an overriding royalty can sue for damages.

Id. (citations omitted).

284. *Id.* at 969.

285. *Id.*

of appeals affirmed a summary judgment for GHR.²⁸⁶ The court noted that the workover agreement provided that, in the event NL did not receive an approved fracture program, NL was required to notify GHR.²⁸⁷ The contract further provided that NL was not to perform the fracture work if GHR failed to respond to such notification within ten days.²⁸⁸ The court concluded that absent such notification by NL to GHR, any injury NL suffered by GHR's failure to obtain Holditch's approval was caused by NL's own breach of the agreement.²⁸⁹ The court also affirmed summary judgment as to NL's claim that GHR breached the agreement by failing to obtain certification of the economic viability of each workover.²⁹⁰ Again, turning to the provisions of the contract, the court noted that the certifications were required to be provided to third parties and not to NL.²⁹¹ According to the court, if GHR breached the contract in that regard, NL was not harmed.²⁹²

With regard to NL's negligence claims, the court of appeals affirmed the summary judgment on the basis of a provision in the workover agreement that required GHR to submit its fracture designs to Holditch for review, authorized Holditch to modify GHR's designs, and provided that any decisions made by Holditch with regard to such designs would be final and binding upon GHR and NL.²⁹³ The court found that such provision appointed Holditch to be an arbiter for the design of the fracture treatments for the ten wells.²⁹⁴ Under Texas law, an arbiter's decision is final and conclusive unless the arbiter is guilty of fraud, misconduct, or such gross mistake as would imply bad faith or failure to exercise an honest judgment.²⁹⁵ Consequently, the appellate court held that Holditch could not be liable to NL on a simple negligence theory.²⁹⁶ The court also found that this provision shielded GHR from liability on claims for negligent design.²⁹⁷

The decision in *Maxvill-Glasco Drilling Co., Inc. v. Royal Oil & Gas Corp.*²⁹⁸ involved claims by a lessee against a third-party for tortious interference with the lessee's oil, gas, and mineral lease. Maxvill was the lessee under an oil, gas, and mineral lease covering 80 acres out of a 320 acre tract from a depth of -9650' to -9800'. The lease required Maxvill to commence drilling a well on the lease premises on or before August 23, 1982. Royal

286. *Id.* at 970.

287. *Id.*

288. *Id.*

289. *Id.*

290. *Id.*

291. *Id.*

292. *Id.*

293. *Id.*

294. *Id.*

295. *Id.* at 964 (citing, *inter alia*, *City of San Antonio v. McKenzie Constr. Co.*, 136 Tex. 315, 326, 150 S.W.2d 989, 996 (1941)).

296. *Id.*

297. *Id.* at 970. "If NL were permitted to argue that GHR did not use reasonable care in designing the fracs even though the designs conformed to the requirements of the contract, Holditch's role would be nugatory because its decision to approve those treatments would be meaningless." *Id.* (citing *Huey v. Davis*, 556 S.W.2d 860, 864 (Tex. Civ. App.—Austin 1977)).

298. 800 S.W.2d 384 (Tex. App.—Corpus Christi 1990, writ denied).

held an oil, gas, and mineral lease covering the 320 acre tract in its entirety from a depth of -7000' to -9650'. On August 4, 1982, Maxvill obtained a permit from the Texas Railroad Commission to drill a well on its 80 acre tract. Royal filed a protest with the Commission seeking to cancel this permit. On August 23, 1982, Royal withdrew its protest, but because Maxvill had not yet commenced the drilling of a well on that date, its 80 acre lease expired. Royal subsequently obtained a lease covering the same 80 acre tract formerly leased to Maxvill from -9650' to -9800'. Royal then drilled and completed a producing well at the same location and to the same depth for which Maxvill had previously obtained its permit from the Commission and thereafter began producing oil and gas from that well.

Maxvill filed suit against Royal, claiming that Royal's protest to the Commission constituted a tortious interference with Maxvill's oil, gas, and mineral lease because Royal's protest had prevented Maxvill from drilling its planned well prior to the expiration of its lease. The trial court granted a directed verdict for Royal on the grounds that Maxvill had failed to prove any recoverable damages.²⁹⁹ Maxvill appealed.

The court of appeals began its analysis by recognizing that the measure of damages for tortious interference with a contract requires the court to put the plaintiff in the same economic position he would have been in had there been no interference with the contract.³⁰⁰ In this case, Maxvill sought to recover the "net profits" that it lost due to Royal's alleged tortious interference with Maxvill's oil, gas, and mineral lease.³⁰¹ In order to recover for "lost profits," the court of appeals noted that sufficient evidence must be presented to enable the jury to determine the net amount of those lost profits with reasonable certainty.³⁰² In this case, Maxvill presented only evidence of gross profits in the form of the total proceeds from production, and did not present evidence regarding costs associated with operation of the well that generated the gross profits.³⁰³ In the absence of evidence establishing the cost of producing the oil and gas in question, the court held that there was no evidence from which the jury could determine the amount of "net profits" which Maxvill may have been entitled to recover, and affirmed the trial court's directed verdict.³⁰⁴

*Wilson v. United Texas Transmission Co.*³⁰⁵ involved claims by a lessor against two gas purchasers for conversion of gas royalties. Wilson granted an oil, gas, and mineral lease in 1981, which provided for 1/4 royalty. The working interest under the lease was ultimately assigned to Clover Energy Corp. The lease was pooled into two separate gas units, and Clover entered into separate gas purchase contracts with United Texas Transmission Com-

299. *Id.* at 386.

300. *Id.*

301. *Id.*

302. *Id.*

303. *Id.* at 387.

304. *Id.*

305. 797 S.W.2d 231 (Tex. App.—Corpus Christi 1990, no writ).

pany (UTTCO) and South Gulf Energy, Inc. for the sale of gas produced from such units.

Wilson sued UTTCO and South Gulf, claiming that they failed to provide him with an accounting, and failed to pay him, for his share of royalty gas produced from the lease for a certain ten month period.³⁰⁶ Wilson claimed that no one ever submitted any proposed agreement to him regarding the sale of gas produced from the lease, and he never authorized anyone to sell such gas. According to Wilson, UTTCO and South Gulf converted his royalty gas since they purchased such gas from Clover, which did not have Wilson's authority to sell such gas. The trial court, however, disagreed with Wilson's analysis, and granted summary judgment for the gas purchasers.³⁰⁷ This judgment was affirmed on appeal.

After examining the entirety of the royalty provision³⁰⁸ in the Wilson lease, the appellate court determined that the parties intended that the gas royalties were to be paid in money rather than in kind.³⁰⁹ The appellate court then turned to settled Texas law, which holds that where royalty is payable in money and the lessee fails to pay the royalty, the lessor does not have an action against a party who purchases the gas unless the purchaser has contracted to pay the royalties to the lessor.³¹⁰ Since the gas purchase contracts at issue did not require UTTCO or South Gulf to pay royalties to Wilson, the court concluded that Wilson could not maintain a cause of action for conversion against either purchaser.³¹¹

*Trevor Rees-Jones, Trustee for Atkins Petroleum Corp. v. Trevor Rees-Jones, Trustee for Apache Services, Inc.*³¹² is a case involving the propriety of a summary judgment granted for lien claimants against working interest owners in certain oil, gas, and mineral leases. In 1985, Atkins Petroleum Corporation owned 100% of the working interest in the leases at issue. In January of 1986, Atkins contracted for services and materials to be furnished by appellees in connection with the drilling of oil and gas wells on the leases. Atkins thereafter entered into a series of letter agreements with appellants to sell them mineral interests in the leases. In the letter agreements, the appel-

306. Wilson's claims were based on a provision of the lease which stated: "LESSEE may dispose of LESSOR'S royalty gas or gaseous hydrocarbons in accordance with any proposed agreement submitted to LESSOR by LESSEE and approved by LESSOR; and thereafter during the life of such agreement LESSEE shall account to LESSOR for said royalty gas on the basis of such agreement." *Id.* at 233 (emphasis omitted).

307. *Id.* at 232.

308. The court focused on that portion of the gas royalty provision that provided the royalties reserved by lessor, and which shall be paid by lessee, are:

(c) on dry gas or residue gas the value of one-fourth (1/4) part of such dry gas or residue gas sold or utilized by LESSEE on or off the premises, less severance and production taxes. The value of such gas is to be based upon the highest market price paid or offered in the general area; or that price which LESSEE receives (sic) for his gas, whichever is greater

Id. at 234.

309. *Id.*

310. *Id.* (citing *Curry v. Texas Co.*, 8 S.W.2d 206, 210 (Tex. Civ. App.—Eastland 1928, writ dismissed)).

311. *Id.*

312. 799 S.W.2d 463 (Tex. App.—El Paso 1990, writ denied).

lants agreed to buy the interests for a specified sum per well to be drilled. If production was obtained, Atkins agreed to assign the appellants specified portions of the working interest. Atkins was to be operator of the producing wells.

In accordance with the contracts, appellees supplied materials and services for the drilling of wells. Apparently, production was established from the wells, because between March and July of 1986, Atkins executed and recorded a series of assignments of working interest to appellants in accordance with the terms of the letter agreements. Atkins, however, failed to pay appellees for the materials and services they furnished. Appellees then filed their lien affidavits and gave notice to Atkins, but not to appellants, even though they had notice that some interest in the leasehold estate had been assigned to appellants at the time they filed their lien affidavits. Appellees then filed suit against appellants, and obtained summary judgment against them for the value of their liens.³¹³

On appeal, the appellants claimed that the appellees had failed to comply with certain requirements in the Texas Property Code regarding liens on mineral interests.³¹⁴ First, appellants contended that they were the mineral property owners,³¹⁵ that Atkins was the mineral contractor,³¹⁶ that the appellees were mineral subcontractors,³¹⁷ and that appellees had failed to provide the statutory notice of their claim required of mineral subcontractors.³¹⁸ The court rejected this argument, noting that the contracts for materials and services were made with Atkins at a time when it owned all of the working interests.³¹⁹ The court, therefore, held that Atkins was the mineral owner and the appellees were mineral contractors, not subcontractors, at the time the contracts for materials and services were made, and that events involving the mineral owner and its assignees after the contracts for materials and services were made could not affect the status of the parties.³²⁰ Having concluded that appellees were contractors, rather than subcontractors, the court held that the only notice that they were required to give under the statute was notice to Atkins, even though they had notice that

313. *Id.* at 264-65.

314. *See* TEX. PROP. CODE ANN. §§ 56.001-.045 (Vernon 1984).

315. "Mineral property owner means an owner of land, an oil, gas, or other mineral leasehold, an oil or gas pipeline, or an oil or gas pipeline right-of-way." *Id.* § 56.001(3).

316. "'Mineral contractor' means 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." *Id.* § 56.001(2).

317. "'Mineral subcontractor' " means a person who:

(A) furnishes or hauls material, machinery, or supplies used in mineral activities under contract with a mineral contractor or with a subcontractor;

(B) performs labor used in mineral activities under contract with a mineral contractor; or

(C) performs labor used in mineral activities as an artisan or day laborer employed by a subcontractor."

Id. § 56.001(4).

318. *See id.* § 56.021.

319. 799 S.W.2d at 465.

320. *Id.* at 466.

some of the interest had been assigned to appellants.³²¹

Second, appellants claimed that some of the lien affidavits at issue failed to satisfy the statutory requirements³²² because the affidavits did not list the appellants as the mineral property owners and because the property description in the affidavit was insufficient. With regard to the identification of the mineral owners, the court held that appellants were not required to be listed as mineral property owners as the result of its previous ruling that Atkins was the mineral owner as to the lien claims at issue.³²³ Regarding description of the lease, the court recognized that the lien affidavit must contain a description of the land or the lease.³²⁴ After examining the affidavits at issue, the court concluded that the property descriptions were adequate because each affidavit used survey descriptions to identify the lease.³²⁵ The court held that this type of description substantially complied with the statutory requirements.³²⁶

*Shelton v. Exxon Corp.*³²⁷ arose out of a settlement of royalty claims between King Ranch and Exxon. Until 1977, Robert Shelton was the executive vice president, treasurer, and member of the board of directors of King Ranch. He was also King Ranch's largest shareholder. In 1976 and 1977, Shelton exchanged his stock for various assets of King Ranch, including royalty interest and mineral interest, which were conveyed to Shelton and his various corporations, including Shelton Ranch Corporation, Shelton Interests, Shelton Ranches, and Shelton Land & Cattle.

In the 1970s, royalties paid by Exxon were a large portion of King Ranch's net income. During that period, Shelton urged King Ranch management to audit Exxon's accounting. When King Ranch conducted such an audit, it discovered that Exxon had not paid all royalties due. King Ranch's total claims for underpayment of royalty were estimated to be worth \$500 million. One of the non-executive mineral interests conveyed to Shelton Land & Cattle included an assignment of 11.22% interest in King Ranch's pending claim against Exxon for underpayment of royalty.

321. *Id.*

322. (a) A lien claimant's affidavit must include:

- (1) the name of the mineral property owner involved, if known;
- (2) the name and mailing address of the claimant;
- (3) the dates of performance or furnishing;
- (4) a description of the land, leasehold interest, pipeline, or pipeline right-of-way involved; and
- (5) an itemized list of amounts claimed.

(b) A mineral subcontractor's affidavit must in addition include:

- (1) the name of the person for whom labor was performed or material was furnished or hauled; and
- (2) a statement that the subcontractor timely served written notice that the lien is claimed on the property owner or the owner's agent, representative, or receiver.

TEX. PROP. CODE ANN. § 56.022 (Vernon 1984).

323. 799 S.W.2d at 466-67.

324. *Id.*

325. *Id.* For example, one affidavit described the leasehold estate as located in the SW/4 of SE/4 of Section 43, Block 39, T-5-S, T. & P. R. R. Co. Survey, Upton County, Texas. *Id.*

326. *Id.*

327. 921 F.2d 595 (5th Cir. 1991).

Shelton urged King Ranch to sue Exxon for the deficiency, but King Ranch refused. Shelton then filed suit against Exxon and King Ranch in state court. In 1980, King Ranch and Exxon settled the royalty dispute, and entered into a settlement agreement purporting to release all claims, including Shelton's, for deficiencies in royalty accruing prior to September 1, 1980. The agreement did not require Exxon to make a cash payment to King Ranch. Instead, the parties agreed that King Ranch's royalty fraction under its lease with Exxon would be increased from 1/6 to 9/48. This 1/48 increase was estimated to be worth \$55 million. Shelton refused to accept his share of the increased royalties.

Shelton's lawsuit was eventually tried as a diversity case in federal district court.³²⁸ At trial, Shelton claimed underpayment of royalty for two periods. For the period from July 1, 1973, through September 1, 1980, Shelton asserted that the 1980 settlement agreement did not release claims against Exxon arising before settlement. The district court, however, disagreed, finding that the settlement agreement by its express terms did release Shelton's claim against Exxon, and that King Ranch was authorized to settle such claims.³²⁹ For the period from September 1, 1980, through December 31, 1984, Shelton claimed that the settlement agreement did not release Shelton's claim against Exxon for failure to prudently market King Ranch gas, and that Exxon imprudently marketed the gas. The district court agreed with this claim and awarded Shelton approximately \$11 million in actual damages, plus additional amounts for attorneys' fees and prejudgment interest.³³⁰ Shelton appealed the district court's judgment with regard to the first period, and Exxon appealed the judgment as to the second period.

The resolution of the issues involved in Shelton's claim relating to the period from July 1, 1973, through September 1, 1980, required the Fifth Circuit court of appeals to examine the specific language of the convey-

328. 668 F. Supp. 1013 (S.D. Tex. 1987), *rev'd and remanded*, 843 F.2d 212 (5th Cir. 1988), *on remand*, 719 F. Supp. 537 (S.D. Tex. 1989).

329. 719 F. Supp. 537, 544-45.

330. *Id.* at 547-50.

ances³³¹ to Shelton and his corporations and the settlement agreement.³³² The Fifth Circuit agreed with the trial court that these provisions in these documents authorized King Ranch to settle the underpayment of royalty claims against Exxon on behalf of the Shelton entities. With regard to the 1977 assignment of claim, the appellate court noted that the language in the assignment was unambiguous, and that Shelton Land & Cattle agreed with the restrictions as part of the bargain.³³³ According to the assignment, Shelton Land & Cattle expressly agreed that King Ranch had the complete authority to deal with the entirety of the claim, including the power to waive the claim altogether. Therefore, Shelton Land & Cattle was held to be precluded by the assignment from pursuing any claim it may have against Exxon for the period before the effective date of the settlement agreement.³³⁴

With regard to the claims of the other Shelton entities, Shelton claimed that the mineral and royalty deeds reserved to the King Ranch the executive right to enforce lease obligations only as to King Ranch's interests in the leases, and not to Shelton's interest in underpaid royalties. Shelton reasoned that the executive right is an interest in real property and pertains only to interest in real property, whereas his claims for royalties on past production were claims to recover personal property, and therefore were not covered by the executive right. The Fifth Circuit recognized that the Texas supreme court held that the executive right is a property interest, subject to the prin-

331. The 1977 assignment to Shelton Land & Cattle of 11.22% in King Ranch's pending claim against Exxon contained the following provision:

The assignment is subject, and Assignee [Shelton Land & Cattle] by its acceptance hereof and joinder herein acknowledges and agrees for itself . . . , to the retention by Assignor [King Ranch] of the exclusive, full, complete and absolute right and power to prosecute and otherwise deal with any Claim for Additional Royalties in any way Assignor . . . see[s] fit, including without limitation the absolute right to waive any Claim for Additional Royalties in its entirety, all without liability to Assignee by reason of such actions; . . . *Assignee shall not be entitled to any payment from Assignor if Assignor shall make settlement of the Claim for Additional Royalties which involves a prospective increase in the royalty or other benefit which inures directly to all owners of mineral interests subject to the Leases in proportion to their respective ownership interests.*

921 F.2d at 598 (emphasis added by court). The conveyances of mineral interests and royalty interests to the other Shelton entities included language the same as, or similar to, the following provision:

King Ranch, Inc., Grantor herein, hereby reserves unto itself . . . the exclusive power and right, without the joinder of the Grantees herein, to execute amendments to the Oil, Gas and Mineral Lease of Exxon Corporation now covering the lands described herein *Grantor . . . shall have the exclusive right to enforce the obligations of such existing or future leases, contracts, and other instruments and to contract and negotiate with the lessee thereunder with respect to each such obligation.*

Id. at 598-99 (emphasis added by court).

332. The settlement agreement between King Ranch and Exxon provided in part: Ranch Interests hereby release Exxon from any and all claims, causes of action and liabilities which have arisen or accrued prior to the effective date of this Settlement Agreement [April 1, 1980] relating to the amount of royalty payable, paid or which should have been paid under the provisions of The Leases

Id. at 597.

333. *Id.* at 598.

334. *Id.*

principles of property law when bundled with other rights and attributes comprising the mineral estate.³³⁵ The court, however, disagreed with Shelton's argument that the executive right encompasses only rights relating to royalty.³³⁶ Noting that the mineral estate consists of a bundle of interests that can be separated, conveyed, or reserved upon any terms the mineral owner deems proper, the court turned to the express language of the mineral and royalty deeds, and determined that King Ranch expressly reserved for itself the right to enforce lease obligations.³³⁷ The court further found that even if accrued royalties were classified as personalty, the duty to pay royalty is still an obligation of the lease.³³⁸ The court therefore concluded that King Ranch had the authority to settle the claims against Exxon as to Shelton's interest for the period from July 1, 1973, through September 1, 1980, and that King Ranch did settle such claims under the 1980 settlement agreement.³³⁹

Prior to addressing Shelton's claim with regard to the second period at issue, the Fifth Circuit discussed Shelton's allegations that even if King Ranch had the right to settle Shelton's claims, King Ranch could only act as Shelton's agent. According to Shelton, the settlement agreement between King Ranch and Exxon was invalid as to his interest because of a conflict of interest between King Ranch and Shelton, or because King Ranch had no authority to act as Shelton's agent over Shelton's objections. The court found that King Ranch did owe some duty to Shelton, and held that the scope of that duty was similar to the duty owed by an executive to a non-executive.³⁴⁰ Relying on the Texas supreme court case of *Manges v. Guerra*³⁴¹ the federal court noted that such duty required the executive to acquire for the non-executive every benefit that it exacts for itself.³⁴² Accordingly, King Ranch would have violated the executive's duty to act with utmost good faith if it manipulated the settlement terms to its own advantage in order to obtain benefits not shared by the non-executives.³⁴³ The Fifth Circuit, however, agreed with the district court's conclusion³⁴⁴ that King Ranch fulfilled its duty, because it obtained for all mineral and royalty interest owners the same consideration for release of the claim.³⁴⁵

With regard to the second period at issue, from September 1, 1980, through December 31, 1984, Shelton claimed that Exxon imprudently marketed the King Ranch gas in the period leading up to the enactment of the NGPA,³⁴⁶ and that its damages for such imprudent marketing continued to

335. *Id.* at 599 (citing *Day & Co. v. Texland Petroleum, Inc.*, 786 S.W.2d 667, 669 (Tex. 1990)).

336. *Id.* at 599-600.

337. *Id.* at 600.

338. *Id.* at 599.

339. *Id.* at 600.

340. *Id.*

341. 673 S.W.2d 180, 193 (Tex. 1984).

342. 921 F.2d at 600.

343. *Id.*

344. 719 F. Supp. 537, 545.

345. 921 F.2d at 600.

346. 15 U.S.C.A. §§ 3301-3432 (West 1982 & Supp. 1988).

accrue after execution of the settlement agreement between King Ranch and Exxon. Shelton contended that Exxon should have stopped marketing gas to corporate customers under long-term contracts subject to the NGPA section 109³⁴⁷ ceiling price. Instead, Shelton argued that Exxon should have sold gas to other customers so as to qualify for a higher ceiling price under NGPA section 105(b)(2).³⁴⁸ Exxon countered that (1) the 1980 settlement agreement released any imprudent marketing claims, and (2) in any event, Exxon acted as a reasonably prudent operator in marketing King Ranch gas.

The appellate court did not reach Exxon's second contention because it found that the settlement agreement did release the imprudent marketing claims. According to the court, any such claims would have accrued in 1978 when the facts came into existence that would entitle Shelton to bring suit.³⁴⁹ The possibility that damages arose only after the effective date of the settlement agreement was held to be irrelevant with regard to the accrual of any such claim.³⁵⁰ Although the settlement agreement did not specifically provide for the release of imprudent marketing claims, the Fifth Circuit held that the broadly-worded release provision in the agreement released all claims, including imprudent marketing claims, that accrued prior to the effective date of the settlement agreement.³⁵¹ Accordingly, the court affirmed in part and reversed in part the district court's judgment, resulting in a favorable outcome to Exxon as to all claims.³⁵²

347. *Id.* § 3319.

348. *Id.* § 3315.

349. 921 F.2d at 602.

350. *Id.*

351. *Id.*

352. *Id.* at 603.