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Stuart C. Hollimon

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OIL, GAS, AND MINERAL LAW

by

Stuart C. Hollimon

I. ISSUES INVOLVING CONVEYANCING

A. Construction of Instruments

RAY v. *Truitt*¹ involved the effect a deed containing a royalty reservation would have on subsequent conveyances. In 1939, Minta White executed a warranty deed to M.F. King conveying land in Midland County, Texas. The deed reserved to White all royalty derived from the land, "royalty" meaning $\frac{1}{8}$ of the production of any minerals.² Later in 1939, White executed eight royalty deeds, each of which conveyed a fraction "of royalty" or "of the royalty." None of the deeds made reference to White's 1939 conveyance to King, nor did they define the term "royalty."

The issues presented for determination in this case were the quantum of royalty reserved by White under the 1939 warranty deed to King and that conveyed by White under the later royalty deeds. The court of appeals held that under the 1939 deed reservation White reserved a fixed one-half of $\frac{1}{8}$ th royalty interest or one sixteenth of production.³ The court reasoned that the parties to that instrument expressly defined the term "royalty" to mean one-eighth of production, and the court could not disregard that definition or substitute another meaning for that term.⁴ The court, however, further held that the definition of royalty contained in the original deed was not binding upon the grantees under White's subsequent royalty deed.⁵ In this connection the court held that the eight royalty deeds were not ambiguous, nor did they, on their faces, refer back to the original deed.⁶ Accordingly, the court found that the later conveyances did not limit royalties to one-eighth of production, but rather gave the grantees of Minta White stated fractions of the total production according to the instruments they held.⁷

1. 751 S.W.2d 205 (Tex. App.—El Paso 1988, no writ).

2. The warranty deed contained the following reservation clauses

Out of the grant hereby made, there is, . . . expected and reserved to . . . Minta White, . . . an undivided $\frac{1}{2}$ interest in and to all of the royalty that may be payable under any and all mineral leases that may be made on . . . lands, and by royalty is *menat* [sic] one-eighth of the production of minerals from said . . . lands.

Id. at 206.

3. *Id.*

4. *Id.* at 207.

5. *Id.*

6. *Id.*

7. *Id.*

The construction of a mineral reservation was also at issue in *Wojtasczyk v. Burns*.⁸ In 1923, the predecessor in interest of Burns conveyed a forty-acre tract of land to the predecessor in interest of Wojtasczyk. The instrument reserved to the grantor all mineral interests in the tract, specifically, gold, silver, coal, oil, and gas.⁹ In 1935, Burns granted to Wojtasczyk one-quarter of the mineral rights previously reserved. Subsequently, Wojtasczyk granted a three-year mining lease to United States Steel Corporation reserving a one-sixteenth royalty.

The law suit arose out of an action by Burns against United States Steel Corporation for payment of three-quarters uranium royalties attributable to the forty-acre tract. United States Steel Corporation interpleaded the funds representing the uranium royalties, and joined Wojtasczyk as a third-party defendant. Wojtasczyk cross-claimed against Burns, claiming entitlement to all uranium royalties attributable to the forty-acre tract. Wojtasczyk argued that the deed rested to the surface owner all uranium rights because the mineral reservation contained in the 1923 deed did not include uranium. The trial court disagreed, granting a take-nothing judgment on Wojtasczyk's cross action.

Wojtasczyk on appeal contended that the trial court erred as a matter of law in holding that he owned only one-fourth of the uranium rather than all of the uranium in the forty-acre tract. Wojtasczyk argued that the trial court should have resolved the issue by application of the surface destruction test.¹⁰ The court of appeals, however, noted that the Texas Supreme Court, in *Schwarz v. State*¹¹ held that a court must only apply this test where necessary to construe an ambiguous conveyance.¹² The court of appeals, therefore, upheld the trial court, reasoning that the 1923 deed was not ambiguous.¹³ The court held that the deed clearly and affirmatively expressed an intention by the grantor to include uranium within the mineral reservation; therefore, the surface destruction test was inapplicable.¹⁴

The court examined the language of the 1923 deed to arrive at its determi-

8. 744 S.W.2d 354 (Tex. App.—Corpus Christi 1988, no writ).

9. *Id.* at 355. The provision contained the following language:

It is specifically agreed, however, that the grantor herein reserves to himself all minerals and mineral rights in and to the above described land, including gold, silver, coal, oil, gas, etc., except water together with the right to take the same therefrom upon paying the grantee, his heirs and assigns, the reasonable market value of all the land reasonably necessary for the taking of such minerals, and all reasonable damage to crops and improvements at the time on the land.

Id.

10. *Id.* The original surface destruction test announced in *Acker v. Guinn* determination that "[u]nless the contrary intention is affirmatively and fairly expressed, . . . a grant or reservation of 'minerals' or 'mineral rights' should not be construed to include a substance that must be removed by methods that will, in effect, consume or deplete the surface estate." 464 S.W.2d 348, 352 (Tex. 1971). Later, in *Reed v. Wylie* the court modified the test so that the issue is not whether removal "must" cause surface destruction, but rather, whether any reasonable method of removal will destroy the surface. 597 S.W.2d 743, 747 (Tex. 1980).

11. 703 S.W.2d 187 (Tex. 1986).

12. 744 S.W.2d at 356 (citing *Schwarz v. State*, 703 S.W.2d 187, 189 (Tex. 1986)).

13. 744 S.W.2d at 356.

14. *Id.* at 356-57.

nation.¹⁵ The 1923 reservation expressly applied to "all minerals" including "gold, silver, coal, oil, gas, etc."¹⁶ The court found that the use of the terms "including" and "etc." suggested that the list of minerals contained in the reservation was illustrative and not exclusive.¹⁷ The court further held that the means of extraction was not a controlling factor in the interpretation of the phrase "all minerals," because the reservation specifically referred to three minerals the extraction of which typically caused surface destruction and two minerals the production of which did not.¹⁸ Finally, the court held that the deed provided for compensation to the surface owner for any surface destruction resulting from the extraction of minerals included in the reservation.¹⁹ For these reasons, the intent to include uranium in the mineral reservation was fairly expressed in the deed thus limiting Wojtasczyk's uranium interest to one-fourth.²⁰

B. Other Issues

*Flag-Redfern Oil Co. v. Humble Exploration Co., Inc.*²¹ involved a declaratory judgment suit brought by Humble against Flag-Redfern to determine ownership of an undivided one-half mineral interest. In 1922 Ped and Emma Scott mortgaged their property and secured payment on their promissory note by executing a deed of trust on the property to J.L. Kocurek. Prior to the due date for the final payment on the note, the Scotts conveyed an undivided one-half mineral interest in the same property to Flag-Redfern's predecessor in interest. The Scotts, unable to pay the note when due, conveyed the fee estate, including all mineral interests, to Kocurek as consideration in satisfaction of the debt. The deed to Kocurek did not mention the previous mineral conveyance to Flag-Redfern's predecessor in interest. Through a series of assignments, Kocurek eventually transferred his interest in the property to Humble.

The issue in the case was whether Flag-Redfern was able to maintain one-half mineral interest in the property despite the Scotts later conveyance of the property in fee to Kocurek.²² The court of appeals affirmed the lower courts granting of summary judgment in favor of Humble.²³ The Texas Supreme Court, however, found that the deed given by Scott to Kocurek in satisfaction of the mortgage debt did extinguish Flag-Redfern's legal title to the one-half mineral interest rights.²⁴

While normally, legal and equitable estates co-exist, under the Texas lien theory of mortgages, executing a deed of trust severs the legal and equitable

15. *Id.* at 356.

16. *Id.*

17. *Id.*

18. *Id.*

19. *Id.*

20. *Id.* at 356-57.

21. 744 S.W.2d 6 (Tex. 1987).

22. *Id.* at 8.

23. *Id.* at 6.

24. *Id.* at 10.

estates in the property mortgage.²⁵ The mortgagor retains the legal title while the mortgagee holds equitable title to the property.²⁶ Accordingly, the court held that by mortgaging the premises to Kocurek, the Scotts disunited the legal and equitable estates in the property.²⁷ The Scotts, therefore, retained ownership in fee of the entire legal estate while Kocurek held the entire equitable estate.²⁸

The Scotts' subsequent sale of an undivided one-half mineral interest to Flag-Redfern vested Flag-Redfern with the legal estate in the undivided one-half of the minerals transferred.

The court determined that as an intervening purchaser of the legal interest, Flag-Redfern's legal title was superior to the interest owned by Kocurek.²⁹ Flag-Redfern's title was originally subject to the equitable interest held by Kocurek under the deed of trust.³⁰ Kocurek, however, forewent his right to foreclose under the deed of trust, and instead elected to acquire Scott's interest in the property by deed in satisfaction of the underlying debt; Kocurek, therefore, acquired only the interest owned by Scott at the time of the conveyance.³¹ Scott's interest included the surface and a one-half mineral interest, but not the undivided one-half mineral interest previously conveyed by Scott to Flag-Redfern.³²

II. ISSUES INVOLVING OIL, GAS, AND MINERAL LEASES

A. *Surface/Mineral Relationship*

The scope of the mineral owner's right to use the surface estate was the subject of *Delhi Gas Pipeline Corp. v. Dixon*.³³ This appeal arose from a trespass action brought by the surface estate owner, Dixon, against the gas buyer, Delhi Gas Pipeline Corporation, for transporting gas produced from other properties in a gathering line across the surface owner's property. In 1973, Dixon purchased a 29.98-acre tract of land through the Texas Verteran's Land Program from Lewie Byers and wife. Dixon, however, owned only the surface estate. The Byers, in the warranty deed to the Verterans' Land Board, expressly reserved all of the oil and gas rights in the tract.

The Byers subsequently executed an oil, gas, and mineral lease to Texas Oil & Gas Corporation. The lease authorized Texas Oil & Gas to explore and drill for oil and gas and to lay pipelines for the storage and transport of any oil or gas produced on the property.³⁴ Pursuant to rights granted in the

25. *Id.* at 8.

26. *Id.*

27. *Id.*

28. *Id.*

29. *Id.*

30. *Id.*

31. *Id.*

32. *Id.* at 9-10.

33. 737 S.W.2d 96 (Tex. App.—Eastland 1987, no writ).

34. *Id.* at 97. The court looked to the language of the following clause in the lease to Texas Oil & Gas to determine Texas Oil & Gas' authority under the lease:

lease, Texas Oil & Gas pooled the Byer's 29.98-acre tract into a much larger unit. A gas well was drilled and completed on lands pooled with the tract. Thereafter, Texas Oil & Gas Corporation entered into a gas purchase agreement with its affiliate, Delhi Gas Pipeline Corporation, for the sale and purchase of gas produced from the unit. The agreement granted Delhi an easement across Dixon's property for the construction and use of a pipeline to transport gas produced from the pooled unit.³⁵ Delhi laid a gas gathering line across Dixon's lands for transporting natural gas from the unit well to its gas transmission line. Delhi did not use the pipeline to transport gas from any other source.

Dixon sued Delhi, claiming this constituted a trespass. The trial court granted Dixon summary judgment, but the court of appeals reversed, holding that a mineral estate owner lessee can properly grant an easement over the surface owner's estate for transportation of oil and gas via pipeline.³⁶ The oil or gas transported, however, must originate on the tract over which the easement is granted, or from a production unit which includes the tract.³⁷ The court relied on case law establishing that a mineral estate owner and his lessee have the right to limit use of the surface estate.³⁸ The surface estate may be used to the extent reasonably necessary for production and removal of oil and gas from a well located on the premises or from a well located on a production unit that included the tract.³⁹

B. Lessee/Lessor Relationship

1. Lease Provisions

*Fuller v. Rainbow Resources, Inc.*⁴⁰ involved the determination of the legal effect of an unusual provision in an oil and gas lease that provided for the payment of additional consideration for the last year of the lease. On Febru-

for the purpose of investigating, exploring, prospecting, drilling, mining and operating for and producing oil, gas and all other minerals, injecting gas, waters, other fluids, and air into subsurface strata, *laying pipe lines*, storing oil, building tanks, power stations, telephone lines, and other structures and things thereon to produce, save, take care of, treat, process, store and *transport said minerals* and other products manufactured therefrom.

Id. (emphasis added by court).

35. *Id.* The purchase agreement between Texas Oil & Gas and Delhi Gas Pipeline Corp. states in pertinent part:

Seller [Texas Oil] hereby assigns and grants to Buyer [Delphi Gas an easement across Sellers properties . . . for the purpose of installing, using, inspecting, repairing, operating, replacing, and removing Buyer's pipelines, meters, and other equipment used or useful in the performance of this Agreement.

Id.

36. *Id.* at 98.

37. *Id.*

38. *Id.* at 97 (citing *Getty Oil Co. v. Jones*, 470 S.W.2d 618, 621 (Tex. 1971) (mineral owner may use surface for production and removal of minerals); *Miller v. Crown Central Petroleum Corp.*, 309 S.W.2d at 876, 878 (Tex. Civ. App.—Eastland 1958, writ *dism'd by agmt*) (surface use allowed for production of oil and gas)).

39. *Id.* at 98.

40. 744 S.W.2d 232 (Tex. App.—Texarkana 1987, no writ).

ary 21, 1982, Fuller executed to Rainbow Resources Inc. a "paid-up"⁴¹ oil and gas lease covering 152.96 acres of land in Rusk County. The lease had a primary term of three years and contained a drilling provision, paragraph 13, which required the lessee to pay \$1,000 additional consideration to maintain the force and effect of the lease throughout the last year.⁴² During the first two years, Rainbow included the leased premises in two pooled units and engaged in commercial production from unit wells. Rainbow, however, failed to pay the additional \$1,000 by February 21, 1984, which marked the end of the second year. By letter dated August 24, 1984, the lessors notified Rainbow of termination of the lease. Rainbow claimed that automatic termination was not proper as paragraph nine of the lease required that the lessor notify the lessee of any breach and allow the lessee sixty days to remedy the breach. On August 30, 1984, Rainbow offered in writing to pay the \$1,000 and on October 19, 1984, Rainbow tendered \$1,000 by cashier's check to the lessors. The Lessors refused both offers of payment.

Based on these facts, the trial court held that the lease automatically terminated on February 21, 1984, due to Rainbow's failure to pay the additional \$1,000. In reversing, the court of appeals characterized the drilling clause, paragraph 13, not as a limitation, but as a promise that provided the lessors with the right to declare and enforce a forfeiture of the lease.⁴³ The court emphasized that construing paragraph 13 as a common law limitation would result in termination of a "paid-up" lease during its primary term for failure to pay additional consideration when the lessee had already drilled and obtained production.⁴⁴ This outcome is contrary to the purpose of a drilling clause.⁴⁵

The court addressed the effect of the notice and grace provisions applicable to forfeitures set forth in paragraph nine of the lease. In this regard, the court held that paragraph nine required the lessors to notify Rainbow in writing that Rainbow had failed to make the additional \$1,000 payment and afford Rainbow sixty days within which to remedy the breach.⁴⁶ The court noted that Rainbow had twice offered to pay the \$1,000 to the lessors within sixty days of the lessors, written notice of Rainbow's breach.⁴⁷ Accordingly, the court held that the lessors had wrongfully refused such offers and concluded that the lease had not terminated.⁴⁸

The court of appeals in *Morris Exploration, Inc. v. Guerra*,⁴⁹ determined that a lessee's tender of minimum royalties did not substitute for actual drilling or production so as to perpetuate the lease term.⁵⁰ The lease between

41. A "paid-up" lease is one that "does not contain a drilling clause and does not mention delay rentals." *Id.* at 233.

42. *Id.* at 233.

43. *Id.* at 234.

44. *Id.*

45. *Id.*

46. *Id.*

47. *Id.* at 234-35.

48. *Id.* at 235.

49. 751 S.W.2d 710 (Tex. App.—San Antonio 1988, writ dism'd w.o.j.).

50. *Id.* at 713.

Guerra, lessor, and CanAm Energy, Inc., lessee, covered a 91.25-acre tract in Webb County, Texas. The lease carried a primary term of three years, and provided for one-eighth royalty on oil and gas production and a special royalty for shut-in wells. The lease further provided that should production cease for sixty days, the lease automatically terminated. In addition, paragraph 15 of the lease stated that if the royalties fell short of five dollars per acre, the lessee must pay the lessor the difference between five dollars per acre and what was actually paid per acre.⁵¹

In February 1987, Guerra filed suit for a declaratory judgment, asserting that the lease had terminated because there had been no production of oil, gas, or other minerals from the leased premises since March 1986. Guerra further claimed that the lessee failed to resume drilling or reworking operations within the sixty-day grace period provided in the lease. Shortly after commencement of this action, defendant Morris Exploration, successor to CanAm Energy, tendered to Guerra a check for the minimum royalties pursuant to paragraph fifteen of the lease. Guerra refused the tender. Morris Exploration took the position that despite the absence of actual production and the commencement of drilling or reworking operations within the prescribed time, the payment of the minimum royalty was tantamount to actual production, and thus the lease was still in effect.

The court of appeals disagreed with Morris Exploration's position.⁵² The court reasoned that paragraph fifteen supplemented the royalty provision, and became operative only when royalties from actual production from any twelve-month period of production were less than \$5.00 per acre per annum.⁵³ Therefore, the lessee must begin actual production and payment of actual royalties before the lessee had the privilege to pay minimum royalties to prevent termination of the lease.⁵⁴ The court distinguished the minimum royalty provision from the shut-in gas clause on the ground that unlike the shut-in gas clause, nothing in paragraph fifteen provided that payment of minimum royalties was equivalent to actual production.⁵⁵ Accordingly, because there was no provision providing for perpetuation of the lease by the payment of minimum royalties, the court concluded that the lease terminated on the sixty-first day following the cessation of production in March

51. *Id.* at 712. Paragraph 15 of the Guerra/CanAm lease provided:

Notwithstanding anything herein to the contrary, it is expressly agreed and understood that in the event that production of oil, gas and other minerals is obtained from the above-described land and the aggregate of the royalties paid to lessor therefrom during any 12-month period of production amounts to less than \$5.00 per acre per annum, for each acre subject to this lease during such 12-month period, then in that event, the lessee, its successors and assigns, agree to pay to lessor (within 60 days after the expiration of such 12-month period by depositing same to lessor's depository hereinabove named) the difference, if any, between the total amount of royalties paid to lessor from this lease during such 12-month period and the aggregate of \$5.00 per acre for the acreage subject to this lease during such 12-month period.

Id.

52. *Id.* at 713.

53. *Id.* at 712-13.

54. *Id.*

55. *Id.* at 713.

1986.⁵⁶

*Bradley v. Avery*⁵⁷ likewise involved a lease provision that provided for termination upon interruption of production or failure of lessee to pay royalties. In 1925 lessees obtained an oil and gas lease covering 100 acres of land in Milam County, Texas. Initially, the lessees drilled and completed production of several wells on the leased premises. Production from those wells, however, declined so that by the summer of 1982 only one well remained in production. On August 1, 1982, for no apparent reason, production ceased from the well. By this time the primary term of the lease had expired. The well remained nonproductive until October 1982, at which time, as a result of work-over operations, the lessees resumed oil production. The plaintiffs, successors of the interests of the lessors, executed division orders in April 1983 and later negotiated royalty checks.

The plaintiffs, despite the division orders, sought a declaratory judgment that the lease terminated prior to October 1982 as a result of the cessation of production described above. The trial court rendered judgment that the cessation of production in 1982 was temporary and therefore did not result in termination of the lease. The court further held that in any event the plaintiff's execution of the April 1983 division orders ratified the lease.

The court of appeals reversed the trial court's judgment and declared that the lease had terminated.⁵⁸ The court of appeals recognized that after termination of the primary term of an oil and gas lease normally results in automatic termination of the lease.⁵⁹ The court also noted that an exception to the rule exists if the lessee can demonstrate that the occurrence amounted to a temporary suspension of production caused by a sudden stoppage of the well or some mechanical breakdown of the equipment or some similar cause.⁶⁰ Upon proof of such circumstances, the lease does not terminate.⁶¹ Instead, the lessee is entitled to a reasonable time in which to remedy the defect and resume production.⁶² In *Bradley*, however, after examination of the district court's record, the court held that the lessee failed to prove that the cessation resulted from a sudden stoppage or a mechanical breakdown in the well equipment.⁶³ The trial court's findings of fact established only that the cause of the interruption in production was "uncertain."⁶⁴ On this basis, the court of appeals held that the record did not support the contention that the cessation of production in 1982 was temporary rather than permanent.⁶⁵

The court of appeals also examined the ratification issue. The court noted that the doctrine of ratification requires proof that the ratifying party executed a formal document that expressly recognized in clear language the

56. *Id.*

57. 746 S.W.2d 341 (Tex. App.—Austin 1988, no writ).

58. *Id.* at 345.

59. *Id.* 343.

60. *Id.*

61. *Id.*

62. *Id.*

63. *Id.*

64. *Id.*

65. *Id.*

validity of the expired instrument.⁶⁶ In this instance, the division order contained no reference whatsoever to the terminated oil and gas lease.⁶⁷ The court, therefore, held that the trial court erred in concluding that the execution of the division order resulted in ratification of the lapsed lease.⁶⁸

2. Implied Covenants

*Sun Exploration Production Co. v. Jackson*⁶⁹ marked the first time the Texas Supreme Court held that an independent covenant of further exploration exists by implication in oil, gas, and mineral leases.⁷⁰ In 1938, the Jackson family leased their 10,000-acre ranch in Chambers County to Sun Exploration and Production Company (Sun). Sun discovered the Oyster Bayou Field on the lease in 1941 and thereafter drilled a total of sixty-five wells. Sun drilled only in the Oyster Bayou Field, which covered approximately 1,800 acres. Sun did not engage in drilling or exploration activities on the remaining 8,200 acres.

The Jacksons, because of such failure to utilize the remaining acreage, denied Sun access to the south half of the lease. Sun brought an action for a judicial declaration that the lease was valid, and for a permanent injunction prohibiting the Jacksons from denying Sun entrance to the lease. The Jacksons counterclaimed seeking cancellation of the lease, asserting that Sun had breached implied covenants to reasonably develop and explore the lease. The trial court, based on jury findings that Sun reasonably developed the lease but failed to reasonably explore the lease, rendered judgment in favor of the Jacksons. The court unconditionally cancelled a portion of the lease and conditionally cancelled much of the remainder of the lease. The court of appeals affirmed the trial court's judgment⁷¹ and Sun appealed to the Texas Supreme Court.

The Texas Supreme Court focused on two main issues. First, Sun asserted that the trial judge was either disqualified, or should have recused himself, because of his relation to the Jacksons. The court found that the trial judge was not constitutionally disqualified from the case,⁷² but did not address the recusal point because its disposition would not affect the court's decision on the merits of the case.

The second issue involved a determination of the nature and scope of the implied covenant of reasonable development. The court recognized considerable confusion in this area of Texas law since the court's landmark decision in *Clifton v. Koontz*.⁷³ The *Clifton* court held that no implied covenant of exploration existed separate and apart from the recognized implied cove-

66. *Id.* at 344.

67. *Id.*

68. *Id.* at 345.

69. 31 Tex. Sup. Ct. J. 604 (July 13, 1988).

70. *Id.* at 608-10.

71. *Id.*

72. *Id.* at 606-08.

73. 160 Tex. 82, 325 S.W.2d 684 (Tex. 1959).

nant of reasonable development.⁷⁴ This gave rise to the assumption that, in Texas, no duty to drill exploratory wells existed.⁷⁵ The *Sun* decision, however, proved this assumption incorrect.⁷⁶ The Texas Supreme Court adopted a new posture with regard to this matter by expressly adopting an implied covenant of further exploration separate and apart from an implied development covenant.⁷⁷ The court redefined the implied covenant of development to include all activities that occur within a known or producing formation.⁷⁸ The implied covenant of exploration applies to activities outside a known or producing formation.⁷⁹

The Jacksons, to prevail on their action for breach of implied covenant of exploration, must have proved the existence of a reasonable expectation of profit to both lessor and lessee resulting from exploration of areas outside the producing field.⁸⁰ In applying this principle to the *Sun* case, the court held that out of four drillable prospects outside the Oyster Bayou Field, only three had chances of success ranging from eight percent to twenty-five percent.⁸¹ Although the drilling of these prospects fell within the ambit of the implied covenant to further explore, the court held that a twenty-five percent chance of discovering hydrocarbons from any given well did not constitute a reasonable expectation of profit.⁸² Thus, Sun did not breach the implied covenant of exploration.⁸³

The precedential value of the court's opinion, however, is subject to doubt. In two separate opinions five justices concurred in the result but held that

74. *Id.* t 696.

75. 31 Tex Sup. Ct. J. at 609.

76. *Id.* at 610. In the words of the court:

In *Clifton*, the court held that the covenant of reasonable development encompassed the drilling of all additional wells after production on the lease is achieved. By 'additional wells' the court meant both additional wells into an already producing formation or stratum, or additional wells into 'that strata different from that from which production is being obtained. . . .' whether the well was exploratory, meaning wildcat, or merely developmental was unimportant. The critical question was whether the lessor could prove a reasonable expectation of profit to lessor and lessee. Therefore, if a party could prove that a reasonable prudent operator would have drilled the well, that well fell within the 'implied covenant of reasonable development,' without regard to whether it was exploratory or developmental.

When this court in *Clifton* expressly refused to recognize an independent covenant of exploration, in actuality, what the court was expressly rejecting was the idea that a lessor need not prove the activity held a reasonable expectation of profit to the lessor and lessee rather than the idea that lessee be obliged to explore the lease. *Clifton* used the term 'development' in a generic sense, meaning exploring, developing, and producing, rather than a technical sense as distinguished from 'exploration.'

Id. at 609-10.

77. *Id.* at 610.

78. *Id.*

79. *Id.*

80. *Id.*

81. *Id.* at 612.

82. *Id.*

83. *Id.*

*Clifton v. Koontz*⁸⁴ was dispositive of the case.⁸⁵ They suggested that the covenant of further exploration was subsumed under the implied covenant of reasonable development. Thus, the jury's finding that Sun had not failed to reasonably develop the lease should have determined the outcome of the case.⁸⁶

*Texas Oil & Gas Corp. v. Hagen*⁸⁷ involved the applicability of an implied covenant of good faith in marketing gas. Hagen and other royalty owners brought a class action against Texas Oil & Gas Corporation (TXO) to recover alleged underpayment of gas royalties and nonpayment of sulphur royalties. The class members were royalty owners under oil and gas leases covering lands in the Pittsburgh Field in Camp County, Texas. TXO operated the leases, and owned practically all of the working interest. In 1970, TXO contracted to sell the gas from the Pittsburgh Field to Delhi Gas Pipeline Corporation (Delhi). Delhi was a wholly owned subsidiary of TXO. The terms of the agreement provided that Delhi purchase gas at certain prices at the wellhead. Royalty on such sales reflected the contract price of the sale rather than the prevailing market value. TXO mailed deviation orders to the royalty owners, and a majority accepted the terms of payment. Because the contract price of TXO gas remained lower than the market value, Delhi resold this gas at a profit.

Hagen, representing the royalty owners, brought suit to recover royalties lost due to the TXO/Delhi agreement. Hagen asserted fraudulent misrepresentation and concealment, breach of contract, and failure to market the gas with good faith and reasonable diligence. The trial court rendered judgment in favor of the royalty owners on all three theories of recovery and awarded recovery of actual damages, exemplary damages and attorney fees. The court of appeals⁸⁸ affirmed the judgment but remanded the case for reassessment of actual damages on the ground that such damages should not exceed the maximum price allowable under the Natural Gas Policy Act of 1978.⁸⁹

On appeal, the Texas Supreme Court affirmed in part and reversed in part.⁹⁰ With regard to the various theories of liability asserted by the royalty owners, the court addressed only whether TXO breached the implied covenant to market the gas with good faith and reasonable diligence. The court rejected the notion advanced by the royalty owners that an oil and gas lease imposes upon the lessee a duty of "highest good faith"⁹¹ placing "the lessee in a position of trust and confidence"⁹² toward the lessor in marketing gas

84. 160 Tex. 82, 325 S.W.2d 684 (1959).

85. See 31 Tex. Sup. Ct. J. at 612-15 (Wallace, J., wrote one concurring opinion in which Culver, J., joined—Kilgarlin, J., wrote a second concurring opinion in which Phillips, J., and Gonzales, J., joined).

86. *Id.*

87. 31 Tex. Sup. Ct. J. 140 (Dec. 16, 1987).

88. 683 S.W.2d 24 (Tex. App.—Texarkana 1984, no writ).

89. 15 U.S.C.A. §§ 3301-3432 (West 1982 & Supp. 1988).

90. 31 Tex. Sup. Ct. J. at 144.

91. *Id.* at 141.

92. *Id.*

for the benefit of itself and the lessor.⁹³ Instead, the court held that the appropriate standard for determining whether a lessee has fulfilled or breached its implied duty to reasonably market gas is that of a reasonable prudent operator.⁹⁴ Applying this standard, the court found evidence that TXO failed to act as a reasonably prudent operator.⁹⁵ A prudent operator under the same or similar circumstances would have obtained both compensation for sulphur recovered from the subject gas and the right to renegotiate the contract price for gas sold to Delhi should the market value of gas escalate.⁹⁶

TXO asserted that it paid royalties under division orders and, in accordance with *Exxon Corp. v. Middleton*,⁹⁷ argued that by TXO's compliance with the orders the royalty owners were estopped from asserting their claim. The supreme court rejected this argument, nothing that the terms of the division orders did not materially alter the method for calculating royalty established under the TXO leases.⁹⁸ The court further stated that the *Middleton* rule did not prohibit royalty owners from protesting an incorrect payment of royalties under division orders consistent with the lease agreement.⁹⁹ Thus, the court held that because the division orders did not call for payment of royalties in a manner inconsistent with that required by the lease, the acceptance of royalties tendered under the division orders did not estop the royalty owners from asserting their claims.¹⁰⁰

The supreme court, however, reversed the award of exemplary damages to the royalty owners.¹⁰¹ The court reasoned that implied covenants such as the implied covenant to reasonably market gas production exist as a part of the written lease agreement and are contractual in nature.¹⁰² Consequently, a breach of an implied covenant is tantamount to a breach of contract and under Texas law, a breach of contract does not give rise to exemplary damages unless there is proof of an independent tort.¹⁰³ Finding no evidence of an independent tort in this case, the court concluded that no basis existed for an award of exemplary damages.¹⁰⁴

III. ISSUES INVOLVING STATE REGULATIONS

A. Force Pooling

The Waco court of appeals in *Railroad Commission v. Bishop Petroleum*,

93. *Id.*

94. *Id.* at 141.

95. *Id.* at 142.

96. *Id.* at 142.

97. 613 S.W.2d 240, 250 (Tex. 1981) (stating that payment made and accepted pursuant to division order is binding and valid until revocation of division order).

98. 31 Tex. Sup. Ct. J. at 142-43.

99. *Id.* at 143.

100. *Id.*

101. *Id.*

102. *Id.*

103. *Id.*

104. *Id.*

Inc.,¹⁰⁵ focused on the issue of whether the Railroad Commission had authority to pool separate reservoirs not in natural communication.¹⁰⁶ In Texas, the Mineral Interest Pooling Act (MIPA)¹⁰⁷ empowers the Railroad Commission to pool separately owned tracts of land that are "embraced in a common reservoir" of oil or gas.¹⁰⁸ In *Bishop*, the Railroad Commission attempted to require pooling of separate reservoirs even though they were not in natural communication with each other. The Commission claimed that it possessed the authority to require pooling of separated reservoirs under the 1979 and 1981 amendments to force-pooling statutes.¹⁰⁹ After reviewing the MIPA and the relevant statutory amendments, the court of appeals rejected the Commission's position.¹¹⁰ The court held that the subject amendments were not intended to alter the effect of prior Texas court decisions limiting the Commission's authority under the MIPA to pool only reservoirs that are in natural, not man-made, communication.¹¹¹

*Railroad Comm'n v. Broussard*¹¹² involved the review of the Railroad Commission's dismissal of a force-pooling application. Prior to submitting the application, Broussard offered to pool his oil interests with an adjoining landowner's. The landowner refused the offer, causing Broussard to seek a forced-pooling order from the Railroad Commission. The Commission rejected the application on the grounds that the voluntary offer to pool made to the adjoining landowner was not fair and reasonable. Broussard appealed to the district court, which reversed the Commission's order, holding that it was arbitrary and capricious. The Railroad Commission appealed to the Austin Court of Appeals.

The appellate court first reviewed the Commission's finding under the "jurisdictional review" standard.¹¹³ Under this standard, Broussard's volun-

105. 736 S.W.2d 724 (Tex. App.—Waco 1987), *aff'd in part, rev'd in part*, 751 S.W.2d 485 (Tex. 1988). In a *per curiam* decision, the Texas Supreme Court affirmed the portion of the court of appeals' judgment that reinstated the force-pooling order. However, the supreme court reversed the court of appeals with respect to its dismissal of a counterclaim by an intervening defendant which sought an accounting for sums due to it for its share of production from the new force-pooled unit. The supreme court remanded the counterclaim to the trial court for consideration. *Id.* at 487.

106. 736 S.W.2d at 730-33. The court determined that "natural communication" did not refer to "separated pools in communication through well bores in single gas producing area or field." *Id.* at 730.

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

108. *Id.* Another section of the statute defines "common reservoir" as a "common pool or accumulation of oil or gas or oil and gas." *Id.* § 86.002(4).

109. *Id.* § 85.046(b) (Vernon Supp. 1989) (authorizing Railroad Commission to permit production by commingling oil or gas or oil and gas where Commission finds commingling will prevent waste, promote conservation, or protect correlative rights); TEX. NAT. RES. CODE ANN. § 85.053(b) (Vernon Supp. 1989) (authorizing Commission to distribute commingled oil and/or gas as if they were a single pool); TEX. NAT. RES. CODE ANN. § 85.055(d) (Vernon Supp. 1989) (allowing distribution of oil and/or gas as if they were a common source of supply); TEX. NAT. RES. CODE ANN. § 86.012(b) (permitting commingling to prevent waste); TEX. NAT. RES. CODE ANN. § 86.081(b) (Vernon Supp. 1989) (allowing treatment of accumulation of oil and/or gas as a single common reservoir).

110. *Bishop*, 736 S.W.2d at 732.

111. *Id.*

112. 755 S.W.2d 951 (Tex. App.—Austin 1988, no writ).

113. *Id.* at 953-54. Texas law requires dismissal of a force-pooling if the Commission fails

tary offer was fair and reasonable if the offeree was draining Broussard's property at the time of the offer.¹¹⁴ The Commission found that, although there may be drainage in the future, there was no drainage from the Broussard tract at the time of the offer.¹¹⁵ The district court found this conclusion to be arbitrary and capricious based on a previous final order by the Commission where the Commission found that a common reservoir existed under the two tracts.¹¹⁶ The court of appeals reversed the district court's decision, holding that the Railroad Commission had the discretion to consider new evidence in determining what was fair and reasonable.¹¹⁷ Thus, the court found that the Commission did not erroneously exercise the discretion committed to it by law.¹¹⁸

The court of appeals also considered the Commission's actions on the basis of a substantial evidence review. Under this form of review, the issue was whether there was substantial evidence to support the Commission's finding of no drainage from the Broussard tract.¹¹⁹ The evidence before the Commission indicated that at the time of Broussard's offer, his lands subject to drainage were not productive. The court held that the MIPA required the Commission to make determinations based on circumstances existing at the time of the pooling offer.¹²⁰ The court affirmed the Commission's dismissal of Broussard's application as substantial evidence existed to prove there was no drainage.¹²¹

American Operating v. Railroad Commission,¹²² involved a similar review of a force-pooling order made by the Railroad Commission. The dispute arose when Southwest Minerals, Inc. attempted to pool 54.9 acres leased by Southwest with approximately 260 acres of a unit operated by American. American's unit was voluntarily formed in January 1982. In August of 1983, Southwest made an offer to American to voluntarily pool Southwest's productive acres with the productive portion of American's unit. Southwest proposed to allocate production and cost of drilling basis of each owner's pro rata share of the productive acreage within the new pooled unit. Thus, each new participant would share in the cost of drilling and completing the well by electing either to pay these costs by tendering cash upon notice of production or by deduction of amounts received from production. Southwest's offer did not propose a risk penalty. American rejected this offer and consequently, Southwest made application for force-pooling under the

to find that the required voluntary offer to pool was fair and reasonable. TEX. NAT. RES. CODE ANN. § 102.013(b) (Vernon 1978). A court's review of the issue regarding whether an offer to pool is fair and reasonable is a 'jurisdictional review.' *Carson v. Railroad Comm'n*, 669 S.W.2d 315, 316 (Texas 1984).

114. 755 S.W.2d at 953.

115. *Id.*

116. *Id.* at 954.

117. *Id.*

118. *Id.*

119. *Id.* at 955.

120. 755 S.W.2d at 956.

121. *Id.*

122. 744 S.W.2d 149 (Tex. App.—Houston [14th Dist.] 1987, writ denied).

MIPA.¹²³ After notice and hearing, the Commission issued an order force-pooling Southwest's acreage with 258.1 productive acres from American's unit. American appealed to the district court of Galveston County, which affirmed the pooling order, and further appealed to the Houston Court of Appeals.

American alleged that the Commission was without jurisdiction to order force-pooling in this case because Southwest's voluntary pooling was not fair and reasonable. American argued that the offer was not fair and reasonable because it included acreage that Southwest knew was not productive and because the offer expressly negated any compensation for risk incurred in drilling the well. With regard to the nonproductive acreage, American claimed that both American and Southwest previously agreed that certain acreage was not productive. Thus, Southwest knew that its offer to pool included nonproductive acreage.¹²⁴ The court, however, concluded that the evidence indicated American and Southwest were not in agreement as to the productive acreage controlled by the other.¹²⁵ The productive limits of the field were controlled by faulting, gas water contact, and a shale outline, all of which were the subject of some dispute.¹²⁶ Furthermore, although Southwest's offer to pool included a small amount of nonproductive acreage, the court held that Southwest could include this acreage in the offer where necessary to permit accurate description of the unit by metes and bounds.¹²⁷ The court found that under these circumstances Southwest's offer was fair and reasonable.¹²⁸

The court next examined Southwest's express negation of any risk factor. The court observed that Southwest declined to include in its offer a penalty for risk because Southwest had no opportunity to participate in the unit well from the outset.¹²⁹ As a result, past production from the unit well drained Southwest's productive acreage.¹³⁰ American contended that this was not a sufficient reason to eliminate a risk penalty, particularly when nine of the eleven wells drilled in the area were dry holes and production from the one producing well began more than a year before Southwest made the offer to pool voluntarily. The court rejected American's contention in this regard, noting that Southwest did not obtain the acreage it sought to pool until eight months after American placed the unit well on production.¹³¹ Concluding that Southwest's elimination of a risk penalty was not unreasonable, and that no statutory provision required that an offer to voluntarily pool contain a

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

124. American bases this allegation on facts presented at a temporary field hearing. Southwest requested a temporary field ruling as a prerequisite to the pooling of its acres with those from the American unit. After a hearing, temporary field rules became effective. These rules, however, did not include any determination of the productive limitations of the new unit. *Id.*

125. *Id.*

126. *Id.*

127. *Id.*

128. *Id.*

129. *Id.*

130. *Id.*

131. *Id.*

risk penalty, the court declined to find Southwest's offer unreasonable.¹³²

B. Other Issues

The Austin Court of Appeals, in *Musick v. Railroad Commission*,¹³³ reviewed the Railroad Commission's denial of a spacing exception. The controversy arose from the discovery of a vacancy tract of slightly more than eight acres. Weymouth Corporation, the surface owner, exercised its statutory right to purchase the tract from the state. Weymouth subsequently leased the land to Musick for development of the minerals. Musick applied to the Railroad Commission for a permit to drill a gas well on the small tract. The Railroad Commission's spacing rules require a distance of at least 330 feet between a well and the nearest property or lease line. The Commission granted exceptions when necessary to prevent waste or confiscation of property. Because the vacancy tract was approximately twenty feet from the property line, the proposed Musick well required an exception to the spacing rule.

Musick claimed the right to an exception to the spacing rule in order to prevent confiscation of her vested right under the lease. The Railroad Commission denied Musick's application because of the rule of law set forth in *Railroad Commission v. Williams*.¹³⁴ The *Williams* Court held that one cannot acquire from the grantor a right to a well permit when the grantor himself had none.¹³⁵ Both the state and Weymouth owned interest in production from nearby wells that drained the gas under the vacancy tract. The Railroad Commission reasoned that the state and Weymouth, Musick's predecessors in title and interest, previously enjoyed a fair and reasonable chance to recover the natural gas in place. The Commission, therefore, would not grant to the state or Weymouth an exception permit. The predecessors in interest had no right to an exception, therefore, neither did Musick.

Musick appealed the Railroad Commission's order to the district court, and then to the court of appeals, claiming the rule in *Williams* did not apply. Music argued that this rule only applies in situations where the grantor by conveyance effected a voluntary subdivision of the tract in question. The *Williams* rule should not apply here because the Commission specifically determined that Musick's tract did not constitute a voluntary subdivision. The court of appeals rejected Musick's contentions, holding that the interpretation of the *Williams* rule advanced by Musick was incorrect.¹³⁶ The *Williams* court merely assumed the absence of a voluntary subdivision of the property but nowhere required this as a determinative factor. Thus, the court held that the *Williams* rule may apply in situations even where there is

132. *Id.*

133. 747 S.W.2d 892 (Tex. App.—Austin 1988, writ denied).

134. 163 Tex. 370, 356 S.W.2d 131 (1967).

135. 356 S.W.2d at 137.

136. *Id.*

no voluntary subdivision of the tract at issue.¹³⁷

Musick next contended that even if the *Williams* rule was applicable, the rule should not operate to deny her the right to a well permit.¹³⁸ Musick claimed that her predecessors in title did have the right to a well permit in order to prevent confiscation thus conferring to Musick the same right.¹³⁹ In this regard, Musick argued that confiscation occurs when surrounding wells do not "entirely drain" a vacancy tract.¹⁴⁰ The court held that this definition of confiscation is incorrect because an interest owner need not wait until complete drainage occurs before recovering its fair share of the production.¹⁴¹ Instead, the proper test of confiscation is whether the owner had a "fair and equal opportunity" to recover its "fair share" of the oil beneath his tract.¹⁴² The court held that since Weymouth had a fair and equal opportunity to recover its fair share of the gas, no right to a spacing exception existed for Weymouth or for Musick.¹⁴³

*Railroad Commission v. A.K. Guthrie Operating Co.*¹⁴⁴ involved the examination of a Railroad Commission order denying a request to change a field allocation formula.¹⁴⁵ The Commission in 1954 assigned to the Sara-Mag field an allocation formula of fifty percent acreage and fifty percent well. In 1982 the field operator filed an application for a permit to drill a well on a substandard-sized tract in the field. At the hearing held with respect to that application, Guthrie, an adjoining landowner, filed a request to change the allocation formula for the field to 100 percent acreage. The Commission denied Guthrie's request, and Guthrie appealed the Commission's order to the district court of Travis County, Texas.

The district court held that on the basis of Texas Supreme Court decisions in *Atlantic Refining Co. v. Railroad Commission*,¹⁴⁶ *Railroad Commission v. Shell Oil*,¹⁴⁷ and *Halbouty v. Railroad Commission*,¹⁴⁸ a field allocation formula based in whole or in part upon a well factor is unlawful as a matter of law. The court of appeals reversed the district court's decision, stating that these Texas decisions did not preclude the Commission from using well factors in its allocation formulae,¹⁴⁹ but instead simply require that alloca-

137. *Id.*

138. *Id.*

139. *Id.* at 896-97.

140. *Id.* at 897.

141. *Id.*

142. *Id.* (citing *Railroad Comm'n v. Williams*, 163 Tex. 370, 356 S.W.2d 131, 136 (1967)).

143. *Id.*

144. 742 S.W.2d 86 (Tex. App.—Austin 1987, no writ).

145. An allocation formula "is the means the Commission uses to distribute oil or gas production among wells in a field." *Id.* at 87.

146. 346 S.W.2d 801, 811 (Tex. 1961) (invalidating allocation formula where .3 acre tract produced at rate many times greater than 320 acre tract and there was insufficient evidence to support the wide discrepancy).

147. 380 S.W.2d 556, 560-61 (Tex. 1964) (invalidating formula that caused unreasonable amount of uncompensated drainage from adjoining tract and not supported by substantial evidence).

148. 357 S.W.2d 364, 376 (Tex. 1962) (invalidating formula for lack of substantial evidence).

149. 742 S.W.2d at 88.

tion formulae that incorporate well factors be reasonably supported by substantial evidence which, the court of appeals explained, had been lacking in the cited decisions.¹⁵⁰

In *State v. Alpha Oil and Gas, Inc.*,¹⁵¹ the Texas Supreme Court considered the enforceability of well-plugging performance bonds to an amount over and above the actual damages incurred when a well is plugged.¹⁵² In *Alpha*, the state sought the full face amount of the bond posted by Alpha to insure coverage of well-plugging expenses. On summary judgement, the trial court did not limit recovery on the bond amount to actual damages incurred.¹⁵³ The court of appeals reversed¹⁵⁴ and the Texas Supreme Court affirmed in a *per curiam* opinion on application for writ of error.¹⁵⁵ The supreme court noted that in some states which view the forfeiture as a penalty for failure to plug, the face amount of the bond is recoverable regardless of the actual amount of damages.¹⁵⁶ The court further recognized that the legislature could impose such a result by statute if it desired.¹⁵⁷ The court nevertheless held, that in the absence of such a statute, common law did not permit forfeiture of the entire bond when that amount exceeds the actual costs of plugging.¹⁵⁸

IV. ISSUES INVOLVING GAS PURCHASE CONTRACTS

A. Take-or-Pay Disputes

In a significant decision, the United States Court of Appeals for the Fifth Circuit, in *Wagner & Brown v. ANR Pipeline Co.*,¹⁵⁹ upheld a deferral to the primary jurisdiction of the Federal Energy Regulatory Commission (FERC) for a determination of whether take-or-pay issues affected the maximum lawful price that could be charged for the gas in question.¹⁶⁰ *Wagner & Brown* brought this action against ANR in state court seeking damages for breach of the take-or-pay provisions of a 1981 contract for the sale of natural gas. ANR removed the action to the United States District Court for the Southern District of Texas and subsequently filed a complaint with the FERC asking the agency to issue an order that the take-or-pay payments at issue would constitute unlawful payments in excess of the maximum price chargeable for the gas under the Natural Gas Policy Act of 1978 (NGPA).¹⁶¹ Con-

150. *Id.*

151. 747 S.W.2d 378 (Tex. 1988).

152. *Id.*

153. *Id.*

154. 736 S.W.2d 167 (Tex. App.—Austin 1987), *aff'd per curiam*, 747 S.W.2d 378 (Tex. 1988).

155. 747 S.W.2d at 378.

156. *Id.* 378-79.

157. *Id.* 379.

158. *Id.* In a subsequent case, the court of appeals followed the *Alpha* decision when presented with the same issues. *Lawyers Surety Corp. v. State*, 753 S.W.2d 703 (Tex. App.—Austin 1988, no writ).

159. 837 F.2d 199 (5th Cir. 1988).

160. *Id.* at 204.

161. 15 U.S.C.A. §§ 3301-3432 (West 1982 & Supp. 1988).

temporarily with the filing of its complaint with the FERC, ANR filed a motion with the federal district court to dismiss Wagner & Brown's lawsuit, contending that the FERC had primary jurisdiction to consider whether the take-or-pay payments at issue violated NGPA price ceilings. The court ruled that the FERC had jurisdiction and dismissed Wagner & Brown's suit.¹⁶²

On appeal, the Fifth Circuit affirmed, but directed the district court to modify its order dismissing the cause to provide for a stay of the action for 180 days.¹⁶³ The state permitted FERC to exercise its jurisdiction.¹⁶⁴ The Fifth Circuit reasoned that the expertise of the FERC on the subject of gas pricing under the NGPA afforded the FERC special competence to determine whether the take-or-pay payments at issue, if made, would result in violation of the NGPA's price restrictions.¹⁶⁵ The court further reasoned that a ruling by the FERC on these issues would create uniformity in the construction of take-or-pay clauses in the face of conflicting district court decisions concerning this issue.¹⁶⁶

The Fifth Circuit rejected numerous objections by Wagner & Brown to the propriety of granting the FERC primary jurisdiction in this case.¹⁶⁷ The court first denied Wagner & Brown's contention that the FERC lacked jurisdiction over the dispute.¹⁶⁸ Wagner & Brown claimed the controversy was purely contractual and therefore was beyond the jurisdiction of the FERC. Alternatively, Wagner & Brown argued FERC jurisdiction was limited to determining the price a producer is entitled to charge for gas. The court rejected this argument, stating that although the FERC's primary duty is to set price ceilings, the scope of this duty necessarily includes authority to make determinations about what cost components are included in the price of gas and about whether the resulting price exceeds the maximum lawful price chargeable under the NGPA.¹⁶⁹

The court likewise denied Wagner & Brown's contention that the district court's action was improper because the FERC in the past has refused all requests that it resolve take-or-pay disputes between producers and pipelines.¹⁷⁰ The Fifth Circuit acknowledged that the agency has demonstrated an unwillingness to act on take-or-pay cases in the past, but concluded that this did not establish that it could not, should not, or would not entertain the issues presented in this action.¹⁷¹ The court pointed out that the FERC had

162. 837 F.2d at 201.

163. *Id.* at 206 (court ordered 180 day stay to protect Wagner & Brown's contract rights until FERC could exercise jurisdiction).

164. *Id.*

165. *Id.* at 201-02.

166. *Id.* While some district courts had held that take-or-pay payments could not violate NGPA price ceilings, others felt that the payments might be a component of price and accordingly subject to the ceilings. *Id.* at 202. "These disparate interpretations underscore the need for a definitive pronouncement from FERC." *Id.*

167. *Id.* at 201-06.

168. *Id.* at 201-02.

169. *Id.* at 203.

170. *Id.* at 204-05.

171. *Id.* at 204.

demonstrated a recent inclination to become involved in the take-or-pay problems confronting the industry.¹⁷² The court pointed to the agency's issuance of Order No. 500, and stated this action belied Wagner & Brown's claim that the agency would not involve itself in this dispute.¹⁷³

The court, however, did agree with Wagner & Brown that the district court had improperly dismissed the action.¹⁷⁴ The court noted that the delay attendant to the resolution of ANR's claims might imperil Wagner & Brown financially and also compromise Wagner & Brown's contract rights.¹⁷⁵ The Fifth Circuit, therefore, directed the district court to modify its judgment by vacating its order of dismissal and substituting an order staying the litigation, thereby allowing the FERC to rule on ANR's complaint.¹⁷⁶

In another gas contract dispute, the Houston Court of Appeals affirmed the trial court's issuance of a temporary injunction in *Valero Transmission Co. v. Mitchell Energy Corp.*¹⁷⁷ The injunction required the pipeline involved to continue to take and pay for gas covered by the contract in accordance with the contract's provisions throughout the pendency of the litigation, subject to any restrictions upon production imposed by Railroad Commission allowable. In *Valero Mitchell*, a gas producer, sued Valero, a pipeline, for the latter's alleged breach of a contractual obligation to take and pay for gas delivered under the contract. The trial court determined that Valero had agreed under the contract to exercise its best efforts to request deliveries of gas sufficient to maintain Mitchell's leases in force and effect. Valero had further agreed to purchase quantities of gas sufficient to protect Mitchell's leases from drainage. The trial court concluded that Mitchell had established a probable right to recover on the merits and issued a mandatory temporary injunction. The injunction required Valero, during the pendency of the case, (i) to prevent drainage of gas from Mitchell's leases by taking and purchasing the full prorated volume of gas allowable for certain designated wells, and (ii) to prevent Mitchell from losing its leases by taking the daily allowable volume of gas from Mitchell's wells.

On appeal, Valero asserted that the trial court lacked subject matter jurisdiction. Valero claimed that the trial court's action constituted a collateral attack upon the rules and regulations of the Railroad Commission and that such matters were under the exclusive jurisdiction of the district courts of Travis County. The court of appeals rejected this contention, holding that Mitchell's suit was for breach of contract.¹⁷⁸ The temporary injunction merely sought to compel Valero's continuing performance of the specific terms of the contract pending a trial on the merits and did not present a challenge to, or seek an exemption from, any rule, regulation, or order of the

172. *Id.*

173. *Id.* at 205.

174. *Id.* at 206.

175. *Id.*

176. *Id.*

177. 743 S.W.2d 658 (Tex. App.—Houston [1st Dist.] 1988, no writ).

178. *Id.* at 661.

Railroad Commission.¹⁷⁹

The court likewise rejected Valero's contention that the temporary injunction violated the rules and regulations of the Railroad Commission.¹⁸⁰ Valero claimed that it had no market for Mitchell's gas, and pointed to Railroad Commission regulations that prohibit a pipeline from taking gas in excess of its market demand.¹⁸¹ Valero reasoned there from that provisions of the temporary injunction that required it to take and pay for gas in excess of its market demand violated the regulations of the Railroad Commission. The court of appeals determined that the injunction's take requirements were consistent with the allowable assigned to the wells in question by the Commission.¹⁸² Then, agreeing that market demand is but one of several factors the Commission takes into account in fixing prorated allowable assigned to the wells, the court concluded that the terms of the injunction did not violate the Commission's rules.¹⁸³

The court then addressed Valero's contention that the force majeure clause contained in the contract excused Valero's performance under the contract and established that Mitchell did not have a probable right to recover on the merits.¹⁸⁴ The court overruled this assertion, holding that a market decline is not an unforeseeable event that would justify relief from a contractual obligation via a force majeure clause.¹⁸⁵ The court of appeals also rejected Valero's contention that the trial court erred in granting Mitchell temporary injunctive relief because Mitchell failed to prove irreparable harm.¹⁸⁶ The court determined that there was evidence from which the trial court could reasonably have concluded that Mitchell's wells were being drained of gas and its leases were in danger of expiring as a result of Valero's failure to take gas from the affected leases.¹⁸⁷ The court noted that the probative value of this evidence was sharply disputed, but nevertheless held that the trial court could reasonably have determined that these factors were causing Mitchell a probable loss impossible to measure precisely.¹⁸⁸ Finally, the court rejected Valero's claim that the trial court abused its discretion by issuing an injunction that disrupted the status quo.¹⁸⁹ The court held that there was sufficient evidence in the record to conclude that the volumes of gas and interim price requirements provided in the temporary injunction accurately reflected the last noncontested purchase agreement existing prior to institution of the suit.¹⁹⁰ The temporary injunction, therefore, did not disturb the status quo, and the court refused to find that the trial court had

179. *Id.* at 660-61.

180. *Id.*

181. Tex. R.R. Comm'n, 16 TEX. ADMIN. CODE §§ 3.30, 3.34 (West 1988).

182. *Id.*

183. *Id.*

184. *Id.* at 664.

185. *Id.*

186. *Id.* at 664.

187. *Id.*

188. *Id.*

189. *Id.*

190. *Id.*

abused its discretion.¹⁹¹

*Wagner & Brown II v. Valero Transmission Co.*¹⁹² involved a take-or-pay claim under a gas purchase contract. Wagner & Brown entered into the gas purchase contract with Valero and Texas Utilities Fuel Company (TUFCO). Wagner and Brown was the seller; the other two parties were the buyer. The take-or-pay clause of the contract provided that the buyer agreed, subject to other conditions and limitations, to purchase an average daily quantity of gas equal to ninety percent of the seller's delivery capacity.¹⁹³ A further provision of the contract provided that the agreement divided the joint rights and obligations of the contract equally between Valero and TUFCO and that each fifty percent interest in all rights and obligations existed severally and separately in the parties.¹⁹⁴ Valero and TUFCO bought ninety-three percent of Seller's delivery capacity during the period in question. Valero took forty-three percent and TUFCO took fifty percent. Wagner & Brown contended that Valero breached the take-or-pay clause. Wagner & Brown reasoned that each of the buyers was obligated to take forty-five percent of the delivery capacity, and since Valero took only forty-three percent, Wagner & Brown was entitled to damages for the breach.

The court of appeals rejected Wagner & Brown's claim.¹⁹⁵ The court held that Valero's obligations to Wagner & Brown would be satisfied in any year that Valero purchased at least forty-five percent of the seller's delivery capacity, or when the combined purchases of Valero and TUFCO were at least ninety percent.¹⁹⁶ The court stated that the contract clause relating to the Valero-TUFCO relationship did not contradict or alter the effect of the take-or-pay provision and did not enlarge Wagner & Brown's right to have ninety percent of its delivery capacity bought by Valero and TUFCO.¹⁹⁷ The court, therefore, concluded that TUFCO and Valero, acting together, fully satisfied the take-or-pay clause by purchasing at least ninety percent of the delivery capacity of the wells involved.¹⁹⁸

In *Kodiak 1981 Drilling Partnership v. Delhi Gas Pipeline Corp.*¹⁹⁹ the court of appeals affirmed a take-nothing judgment on a claim for deficiencies in take-or-pay payments allegedly owing under a gas purchase contract and damages for alleged discriminatory or nonratable taking of gas.²⁰⁰ Kodiak and Delhi, in December 1981, entered into a one-year gas purchase agree-

191. *Id.*

192. 737 S.W.2d 63 (Tex. App.—El Paso 1987, writ denied).

193. *Id.* at 64.

194. *Id.* The provision read:

It is understood that the rights of Valero and TUFCO and their obligations pursuant to this Contract will be several and separate, not joint, each having 50 percent of any interest herein expressed in them jointly; and each bearing only 50 percent responsibility as to any obligation expressed herein as the joint obligation of the two companies. *Id.*

195. *Id.* at 65.

196. *Id.*

197. *Id.*

198. *Id.*

199. 736 S.W.2d 715 (Tex. App.—San Antonio 1987, writ ref'd n.r.e.).

200. *Id.* at 724.

ment under which Delhi agreed to take and purchase 80 percent of the gas Kodiak has available for delivery each day from the lands covered by the contract. The agreement required Delhi to pay for 80 percent of the available gas even if not taken. Delhi, however, was not liable for deficiencies in fulfilling its purchase requirements to the extent those deficiencies were due to force majeure.²⁰¹ The gas involved was produced from "tight sands"²⁰² and, was, therefore, subject to section 107 of the NGPA.²⁰³ In May of 1983, Delhi ceased taking any gas from Kodiak and the lawsuit followed.

The trial court rendered a take-nothing judgment. The court reasoned that the occurrence of a force majeure condition suspends a party's obligation to perform its obligations under a contract, and since the failure of the resale market for section 107 gas was an event of force majeure under the contract Delhi's failure to perform such obligation was not a breach of the gas purchase contract. The court also noted that there was no evidence to support Kodiak's claim that Delhi had discriminated against it by ceasing to take gas.

The court of appeals affirmed.²⁰⁴ The court concluded that the trial court was correct in holding that a force majeure condition existed under the terms and provisions of the gas purchase contract.²⁰⁵ The court applied the test set forth in *Gulf Oil Corp. v. Federal Energy Regulatory Commission*.²⁰⁶ The *Gulf* test required that a party attempting to use force majeure to excuse performance must show (i) the occurrence of the force majeure event, (ii) that the force majeure event caused the failure to perform, and (iii) that the party used due diligence to overcome the force majeure condition once it occurred.²⁰⁷ The court of appeals, however, rejected the requirement that the force majeure event be unforeseeable, nothing that such a requirement had not been approved by any Texas court, state or federal.²⁰⁸ The court of appeals also concluded that the trial court was correct in holding that there was no evidence that Delhi discriminated against Kodiak by not buying gas

201. The force majeure provision in the gas purchase agreement provided:

Except for buyer's obligation to make payment for gas delivered hereunder, neither party hereto shall be liable for any failure to perform the terms of this Agreement, when such failure is due to 'force majeure,' as hereinafter defined. The term 'force majeure' as due to 'force majeure,' as hereinafter defined. The term 'force majeure' as employed in this Agreement shall mean . . . partial or entire failure to gas supply or market or any other cause, whether of the kind herein enumerated or otherwise, not reasonably within the control of the party claiming 'force majeure,' the same shall so far as possible, be remedied with all reasonable dispatch.

Id. at 716.

202. "Tight" formations are lawyers of rock that are cemented together such that the flow of gas through the rock is greatly hindered. As a result, producers generally must use enhanced recovery techniques in order to retrieve gas from these formations at a commercially acceptable rate. WILLIAMS AND MEYERS, *MANUAL OF OIL AND GAS TERMS* 908 (4th ed. 1984).

203. 15 U.S.C. § 3317 (1982).

204. 736 S.W.2d at 724.

205. *Id.* at 721-22.

206. 706 F.2d 444 (3d Cir. 1983), *cert. denied*, 464 U.S. 1038 (1984).

207. 736 S.W.2d at 720.

208. *Id.* at 720-21.

and, further, that Kodiak had waived any nonratable taking or discrimination claim it may have had by refusing Delhi's offer to take ratable volumes from Kodiak.²⁰⁹

*Lively Exploration Co. v. Valero Transmission Co.*²¹⁰ involved another take-nothing judgment rendered in a take-or-pay lawsuit. The opinion primarily addressed points of error regarding evidence and the jury charge, but is noteworthy for its treatment of the Texas Railroad Commission's Gas Market Demand Rule. Lively claimed Valero breached its obligations under a gas purchase contract by failing to pay for the daily contract quantity of natural gas during certain periods. The trial court, in accordance with the jury findings, entered judgment that Lively take nothing from Valero. Lively appealed, contending that the trial erred in admitting evidence of the Gas Market Demand Rule and including the rule in the jury charge. Lively claimed that the Gas Market Demand Rule did not relieve Valero of its obligation to pay for the minimum quantity of gas provided by the contract.

The San Antonio court of appeals noted that evidence is generally admissible if it tends to prove or disprove some issue in the case.²¹¹ The court also noted the Railroad Commission promulgated the Gas Market Demand Rule to direct the efficient recovery of natural gas by targeting monthly production quantities and regulate the fair appropriation between different producers.²¹² The court, therefore, found that the rule was relevant and material on the issue of the quantity of gas that Lively had available for delivery.²¹³ Finally, application of the Gas Market Demand Rule tended to disapprove that there had been a breach of the take or pay provision; the court, therefore concluded that the rule was admissible and the trial court had not erred when it included the rule in the jury charge.²¹⁴

B. Other Issues

*Enserch Corp. v. Houston Oil & Minerals Corp.*²¹⁵ presented a dispute arising under a price redetermination provision contained in a gas purchase contract. Houston Oil & Minerals (HOM), the seller, sued Enserch, the buyer, for money allegedly due under a twenty-year gas purchase contract between HOM and Lone Star Gas Company, a division of Enserch. The contract allowed the parties to redetermine the purchase price of the gas on a periodic basis. The new price was based on the average of the two highest unit prices being charged in the area for gas under similar intrastate contracts. On November 12, 1979, HOM gave notice of its intent to redetermine the contract price by adopting the price term of two designated contracts, effective February 1, 1980. The unit price under the two contracts was the current market

209. *Id.* at 723-24.

210. 751 S.W.2d 649 (Tex. App.—San Antonio 1988, no writ).

211. *Id.* at 652, citing *Dallas Ry. & Terminal Co. v. Oehler*, 156 Tex. 488, 490-91, 296 S.W.2d 757, 759 (1956).

212. 751 S.W.2d at 652.

213. *Id.*

214. *Id.*

215. 743 S.W.2d 654 (Tex. App.—Houston [1st Dist.] 1987, writ denied).

price. The price included an amount allocable to the reimbursement of severance taxes and an amount derived based on section 102 of the NGPA²¹⁶ plus escalations. Enserch refused to pay the redetermined price and instead, beginning in 1980 and for each subsequent year in dispute, paid HOM the section 102 base price in effect on February 1 of each contract year. HOM filed for damages and for a declaratory judgment that the redetermined contract price properly included the monthly price escalations and severance tax reimbursement provisions that were component parts of the market price under the contracts designated by HOM for use in calculating the redetermined price.

The trial court granted HOM's motion for summary judgment. The Court of Appeals affirmed in part and reversed in part.²¹⁷ The court held that the redetermined price included the monthly price escalations but not an amount allocable to reimbursement of severance taxes.²¹⁸ The court determined that the price redetermination provisions of the HOM contract reflected the parties intent to be bound by a market price value determined by third-party contracts and that this concept included price escalations incorporated into the third-party contracts unless prohibited by law.²¹⁹ The court concluded that because the NGPA authorized price escalations of the kind involved, HOM could properly include them as part of the redetermined contract price.²²⁰ The court reached the opposite result, however, on the matter of reimbursement of severance taxes.²²¹ The court held that the contract expressly placed the burden of severance taxes upon HOM and did not provide for reimbursement of those taxes.²²² The court, therefore, concluded that the parties did not intend that Enserch acquire this obligation by means of a price redetermination.²²³

V. MISCELLANEOUS ISSUES

In *Scott v. Exxon Corp.*²²⁴ the Texas Supreme Court reversed the Texarkana Court of Appeals and held that a surface estate owner of mineral classified land was not entitled to share in the proceeds received by the state in settlement of a lawsuit involving the mineral estate.²²⁵ Mineral classified land is former public land in which the State of Texas retains the mineral interest and that is subject to the Relinquishment Act.²²⁶ The Relinquishment Act provides that the State appoints the surface owners of mineral classified land as leasing agents for the state.²²⁷ The state thus relinquishes

216. 15 U.S.C. § 3312 (1982).

217. 743 S.W.2d at 658.

218. *Id.*

219. *Id.* at 657.

220. *Id.* at 656-57.

221. *Id.* at 657-58.

222. *Id.*

223. *Id.*

224. 31 Tex. Sup. Ct. J. 565 (July 9, 1988).

225. *Id.* at 567-68.

226. TEX. NAT. RES. CODE ANN. §§ 52.171-.189 (Vernon 1978 & Supp. 1988).

227. *See id.* § 52.171.

to the surface owners the sole authority to lease the state's minerals on behalf of the state and the school children of Texas. The Relinquishment Act entitles surface owners to share with the state one half of all royalties, bonuses, rentals, or other sums received under the mineral leases.²²⁸ The shared receipts act as consideration for the surface owners service as agents and as payment for the inevitable surface damages to the land resulting from mineral exploration.²²⁹

In *Scott*, the Duval County Ranch Company (DCRC) owned certain nonmineral classified land and certain mineral classified land. DCRC executed an oil and gas lease, in 1925, to the predecessor in interest of Mobil Producing Texas and New Mexico, Inc. and Mobil Oil Company (collectively referred to as Mobil). Later, Clinton Manges and DCRC together owned 69.6 percent and Exxon owned 30.4 percent of the surface estate of the mineral classified land governed by the Mobil lease. Manges, on behalf of himself and DCRC, and as agent for the state under the Relinquishment Act, brought suit, in 1982, against Mobil, Exxon, royalty owners, and some of the farmees for a judicial declaration that Mobil's lease had terminated. Mobil was the only defendant served with citation. The State of Texas intervened as a plaintiff in the lawsuit in early 1983. Manges and the state reached an agreement with Mobil, but prior to settlement, Exxon filed an answer in the lawsuit. Exxon crossclaimed against Mobil for termination of the lease, and counterclaimed against the state and Manges for award of a portion of the impending settlement. Exxon dropped its crossclaim against Mobil prior to the hearing set to enter judgment on the settlement agreement and the trial court severed Exxon's counterclaim. The plaintiffs nonsuited Exxon and proceeded with their settlement agreement with Mobil.

The settlement agreement provided that the parties would treat the Mobil lease as still in effect, dismiss the lawsuit, and release all claims against Mobil. Mobil, in return, agreed to assign the lease to the state and Manges, but retained a one-sixty-fourth overriding royalty interest in the nonmineral classified lands. Mobil then assigned the lease to an intermediary bank as trustee for Manges, DCRC, and the state and reserved its overriding royalty interest as agreed. On the same day, the intermediary bank assigned the nonmineral classified land portion of the lease to a trustee for Manges and the mineral classified land portion of the lease to Scott, as trustee for the state's interest.

Exxon alleged in its severed counterclaim that as owner of an interest in the surface estate of mineral classified land governed by the Relinquishment Act it was entitled to a proportionate share of half of any consideration the state received in settlement of the Mobil lawsuit. The supreme court reviewed the relevant sections of the Relinquishment Act and noted that two rationales supported the award of half of the benefits received under a mineral lease to the surface owners of mineral classified lands.²³⁰ The award

228. *See id.* §§ 52.172, .182.

229. *Id.*

230. 31 Tex. Sup. Ct. J. at 567.

represented compensation for expected damages to the soil, and payment for services as agent for the state.²³¹ The court held that neither policy justified the award to Exxon of a proportionate share of one half of the settlement consideration.²³² The soil damage rationale did not justify any award to Exxon both because the surface owners had received compensation at the time of the Mobil lease in 1925, and because there was no surface damage attributable to the assignment to Scott.²³³ The court also held that Exxon was not entitled to compensation for any services acting as the agent for the state.²³⁴ Exxon chose not to participate in developing and prosecuting the lawsuit against Mobil; Exxon, therefore, did not provide the state, as its principal, any valuable service that might entitle it to a portion of the settlement.²³⁵ Exxon's claims for compensation thus failed.

*Dorchester Gas Producing Co. v. Harlow Corp.*²³⁶ involved one of the many "white oil"²³⁷ disputes prevalent in the Texas Panhandle Field. By assignment, Panoma Corporation was the owner of the working interest in an oil and gas lease. The Panoma Corporation, by an instrument entitled "Assignment of Oil Rights," assigned Hagy all of its interest in the lease insofar as the leasehold estate covered "the oil and oil rights" to producing horizons "situated in whole or in part above sea level."²³⁸ The instrument further provided that the assignment did not cover any "gas or gas rights" under the leasehold.²³⁹ Dorchester became the successor in interest to Panoma Corporation, and Harlow Corporation and its partners succeeded Hagy in interest.

Dorchester and its predecessors had been producing gas from the Brown Dolomite formation under the lease since the 1940s. The Brown Dolomite formation is situated above sea level under the relevant lease and is gas-indigenous. The dispute between the parties arose after 1979 when Harlow, which was producing oil and casinghead gas from formations other than the Brown Dolomite formation, perforated two wells in the Brown Dolomite formation. Harlow began production of gas from the Brown Dolomite formation in addition to oil, gas, and casinghead gas from other formations. Dorchester brought suit against Harlow seeking declaratory relief. Dorchester sought to establish its title in all of the gas, including casinghead gas, in all formations in and under the property and sought damages for the conversion of gas. At trial, the jury found that Harlow had produced 187,125 MCF of "Dorchester gas," meaning gas other than casinghead gas, from the property in question. The trial court ordered Harlow to pay Dorchester damages and permanently enjoined Harlow from producing gas from the Brown Dolomite formation under the property. Both parties ap-

231. *Id.*

232. *Id.*

233. *Id.* at 568.

234. *Id.*

235. *Id.*

236. 743 S.W.2d 243 (Tex. App.—Amarillo 1987, no writ).

237. "White Oil" is gas condensate, or gas that has been liquified by reduced pressure on temperature. WILLIAMS AND MEYERS, *MANUAL OF OIL AND GAS TERMS* 153 (4th ed. 1984).

238. *Id.* at 248.

239. *Id.*

pealed. The court of appeals affirmed, holding (i) that owners of the "oil and oil rights" phase were entitled to produce casinghead gas, but not gas in a gas-indigenous formation and (ii) that actions regarding title and damages for conversion were not impermissible collateral attacks on decisions of the Texas Railroad Commission.²⁴⁰

Harlow argued, on appeal, that casinghead gas included any gas produced with oil. Harlow also claimed that casinghead gas was an oil right, and under the assignment of oil rights Harlow owned, as casinghead gas, any and all gas from any formation where gas is produced with oil in a gas/oil ratio of 100,000 cubic feet or less of gas to one barrel of oil. Dorchester, on the other hand, argued that casinghead gas was a "gas and gas right," which was specifically excepted and reserved to Dorchester under the Assignment of Oil Rights. The court of appeals disagreed with both parties.²⁴¹ Oil, gas, and casinghead gas were defined by statute at the time of the assignment. Oil meant "crude petroleum oil," "crude petroleum" and "crude oil."²⁴² Gas meant "natural gas."²⁴³ The relevant statute defined casinghead gas as any "gas and/or vapor indigenous to an oil stratum and produced from such stratum with oil."²⁴⁴ The court recognized that both parties to the assignment of oil rights were experienced in the oil and gas business and familiar with its terms and customs.²⁴⁵ The court found that at the time of the assignment oil and gas rights commonly included casinghead gas.²⁴⁶ Furthermore, at the time of the assignment Panoma Corporation had been producing natural gas from the Brown Dolomite formation for a number of years by a gas well located on the property in question. The court thus concluded that Panoma conveyed the oil in the oil indigenous formation or strata in and under the property along with the casinghead gas (i.e. gas and/or vapor indigenous to an oil stratum and produced from such stratum with oil), but reserved all of the gas in the Brown Dolomite formation and all gas from any other gas indigenous formation in and under the property.²⁴⁷ The court disagreed both with Harlow's position that casinghead gas included all gas produced by a well classified as an oil well, and with Dorchester's claims that the exception and reservation in the assignment of oil rights reserved to Panoma Corporation all gas including casinghead gas in all formations in and under the property.²⁴⁸ The court instead adopted the statutory definition of casinghead gas and concluded that the casinghead gas is an oil right.²⁴⁹

240. *Id.* at 250-52.

241. *Id.* at 249-51.

242. Act of Apr. 13, 1935, ch. 86, § 1, 1925 Tex. Gen. Laws 180, 181, *repealed by* TEX. NAT. RES. CODE ANN. § 85.001(b) (Vernon 1978).

243. Act of Apr. 13, 1935, ch. 76, § 1, 1935 Tex. Gen. Laws 180, 181 (repealed 1978).

244. Act of May 1, 1935 ch. 120, § 2(i), 1935 Tex. Gen. Laws 318, 319, *repealed by* TEX. NAT. RES. CODE ANN. § 86.002(10) (Vernon 1978).

245. 743 S.W.2d at 249.

246. *Id.* at 250.

247. *Id.*

248. *Id.* at 250-51.

249. *Id.*

Harlow also contended that Dorchester's suit constituted an impermissible collateral attack upon the Texas Railroad Commission's primary jurisdiction and authority. Harlow claimed the suit attacked both the Commission's 1935 order designating the entire Panhandle Field a common reservoir, and constituted an impermissible collateral attack upon Commission decisions determining classification of their wells as oil wells and determining the permissible gas/oil ratio in their oil wells. The court of appeals rejected this contention, stating that the nature of Dorchester's action against Harlow was one to determine title to all of the gas and gas rights in the property in question and to recover the value of gas allegedly converted by Harlow.²⁵⁰ The court noted that the Texas Railroad Commission does not have authority to determine title to land or property rights and that Dorchester's title action and conversion action involved the rights to property.²⁵¹ The court, therefore, held that such actions were within the trial court's jurisdiction and did not constitute an impermissible collateral attack on the Railroad Commission's jurisdiction.²⁵²

In *Cabot Corp. v. Brown*²⁵³ the Texas Supreme Court held that payments of royalty under the terms of an executed division order protected a lessee from liability for the alleged breach of an implied covenant to reasonably market the gas subject to the division order.²⁵⁴ Brown was one of several lessors of a certain gas well while Cabot was the lessee-operator. The royalties payable under the lease for gas used or sold off the premises were based on the market value of gas at the well. Subsequently to signing the lease, however, the lessors signed division orders that required Cabot to pay royalties based on the price for the gas as determined by the Federal Power Commission if the sales of the gas were subject to the Federal Power Commission authority. Cabot delivered the gas involved to Transwestern Pipeline Company under a gas exchange contract in Roberts County, Texas. Transwestern measured and commingled it with interstate gas in Transwestern's interstate gas transmission system. Transwestern delivered equivalent volumes of gas to Cabot in Gray County, Texas. From 1974 Cabot used the exchange gas at its plant in Pampa, Texas, where it commingled the exchange gas with intrastate gas. Cabot sold the majority of this commingled gas for \$1.35 per mcf on the intrastate market under an exemption for state-specific gas that allows a price higher than the ceiling established by federal regulations.²⁵⁵ Cabot paid Brown royalties based on the price of thirty-eight cents per mcf from March 1977 to October 1980; and from October 1980 to the date of trial, it paid on the basis of eighty center per mcf. Both prices were in accordance with federally regulated price ceilings applicable to gas of this kind. Brown sued Cabot in March 1981, claiming that Cabot had breached its duty to reasonably market the gas. Brown claimed the gas had

250. *Id.* at 251.

251. *Id.* at 252.

252. *Id.*

253. 754 S.W.2d 104 (Tex. 1987).

254. *Id.* at 108.

255. See 15 U.S.C. § 717(c) (1982).

never been dedicated to the interstate market and, even if the delivery of this gas to Transwestern under the Cabot-Transwestern exchange agreement affected a dedication of the gas to interstate commerce, Cabot had a duty as a reasonably prudent operator to seek and abandonment of its service to Transwestern. Brown asserted that under either theory the subject gas should have been made available for marketing at higher intrastate prices, which, in turn, would have generated additional royalty for her account. Brown sought damages based upon the difference between the royalties she received and those she allegedly would have received had Cabot prudently marketed this gas.

The supreme court avoided those issues, and instead addressed the effect of the division orders executed by Brown. The court, following *Exxon Corporation v. Middleton*,²⁵⁶ found that the division orders were binding upon Brown and the other royalty owners until revoked and that the orders fixed the basis upon which royalties were payable on gas subject to their terms.²⁵⁷ The court also found that the gas involved was subject to federal regulation and the division order expressly provided the method for calculating royalties on the gas under those circumstances, Cabot had correctly paid royalties on the gas until the division orders were revoked.²⁵⁸ Pointing to its *Middleton* decision, the supreme court further held that the division orders involved here were not effectively revoked until Brown served Cabot with copies of her pleadings and that Cabot, therefore, was not liable to Brown for any damages accruing prior to that time.²⁵⁹ The court then remanded the cause to the trial court to allow Brown and the other lessors to establish what damages, if any, occurred after the division orders were revoked.²⁶⁰

*Strata Energy, Inc. v. Gavenda*²⁶¹ is the second appeal on a suit for recovery of money for deficiencies in royalty payments. In 1967 the Gavendas sold land, reserving a fifteen-year, one-half nonparticipating royalty interest. The Gavendas eventually leased the land under an oil and gas lease, providing for a one-eighth royalty. Strata Energy and Northstar Resources acquired the working interest in the lease through a series of conveyances and completed a producing well on the land in 1979. Strata prepared division and transfer orders in accordance with an erroneous division-order title opinion, which indicated that the gavendas were entitled to a one-sixteenth royalty. The Gavendas signed the division and transfer orders and received the disbursements thereunder even though they were actually entitled to a one-half royalty. The Gavendas revoked the division and transfer orders two days prior to the expiration of the fifteen-year royalty interest, and later brought suit to recoup the underpaid royalties. Strata defended, claiming that under *Exxon Corp. v. Middleton*²⁶² the Gavendas were bound by the

256. 613 S.W.2d 240 (Tex. 1981).

257. 754 S.W.2d at 107.

258. *Id.*

259. *Id.* at 108.

260. *Id.*

261. 753 S.W.2d 789 (Tex. App.—Houston [14th Dist.] 1988, no writ).

262. 613 S.W.2d 240 (Tex. 1981).

division and transfer orders until the orders were revoked.

On appeal, the Texas Supreme Court in 1986 recognized the general rule stated in *Middleton* that division and transfer orders bind underpaid royalty owners until revoked.²⁶³ The court noted, however, that the rule has no application where the operator prepared the erroneous orders and retained the benefits.²⁶⁴ The court, therefore, held that the division and transfer orders did not bind the Gavendas, and decreed that Strata was liable to the Gavendas for the portion of their royalties retained, excluding amounts paid to overriding or other royalty owners.²⁶⁵ The court then remanded the case to the trial court for this determination.²⁶⁶

On remand, the trial court rendered judgment for the Gavendas for \$2,014,540.47, representing one-half of the gross production proceeds less severance and windfall profit taxes, \$335,756.75 previously paid to the Gavendas, and \$335,756.75 paid to the lessor. Strata appealed, claiming that it was entitled to offsets and credits for royalties paid to the overriding royalty owners and to the other working interest owners. The Houston court of appeals disagreed, however, and held that Strata and Northstar were not entitled to a credit for the royalties paid to the overriding royalty interest owners since the working interest created such interests.²⁶⁷ The court similarly denied Strata and Northstar a credit for those "royalties" previously paid to the other working interest owners who were assignees of Strata or Northstar.²⁶⁸ The appellate court held that Strata and Northstar were entitled only to credits for those Gavenda royalties which they paid to others.²⁶⁹ The court reasoned that those were the only royalty payments that did not benefit Strata and Northstar to the financial detriment of the Gavendas.²⁷⁰ The overriding royalty interest and the interests of the assignees of Strata and Northstar were carved out of the working interest; the court, therefore, concluded that a credit for payments to such interest owners would permit Strata and Northstar to profit at the expense of the Gavendas.²⁷¹

*Flournoy Drilling Co. v. Walker*²⁷² addressed the effect the death of the mineral owner has on a drilling contractor's right to perfect a statutory oil and gas lien²⁷³ to secure payment for his services. Walker, the operator and mineral owner of certain leased lands, hired Flournoy to drill wells. Flournoy drilled, but Walker died before full payment was made to

263. *Gavenda v. Strata Energy, Inc.* 705 S.W.2d 690, 691 (Tex. 1986).

264. *Id.* at 692. See *Stanolind Oil & Gas Co. v. Terrell*, 183 S.W.2d 743 (Tex. Civ. App.—Galveston 1944, writ ref'd) (holding that lessor who executed division order with royalty provisions contrary to the terms of the lease did not modify or waive her rights under the lease).

265. 705 S.W.2d at 693.

266. *Id.*

267. *Id.* at 791.

268. *Id.*

269. *Id.*

270. *Id.*

271. *Id.*

272. 750 S.W.2d 911 (Tex. App.—Corpus Christi 1988, writ denied).

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

Flournoy. After Walker's death, Flournoy complied with the statutory requirements for securing a lien covering Walker's mineral properties. Walker's executor, however, refused to recognize Flournoy's lien and Flournoy brought suit. The single issue at trial and upon appeal was whether the death of a mineral owner prior to the filing of the required lien affidavit invalidates the statutory oil and gas lien. The trial court held the lien invalid, concluding that Flournoy's ability to perfect the lien expired upon the death of Walker. The court of appeals reversed, holding that Flournoy had a valid and enforceable lien against the mineral properties.²⁷⁴ The court reasoned that the Texas Legislature specifically provided a time period within which to secure a mineral lien and to permit the owner's death to terminate the contractor's ability to perfect such lien would create a judicial exception to a statutory scheme where no such exception exists.²⁷⁵ The court, therefore, held that the right to file such a lien does not terminate upon the death of the owner of the property.²⁷⁶

274. *Id.* at 913.

275. *Id.*

276. *Id.*