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Stumpf v. Fidelity Gas Co., 294 F.2d 866 (9th Cir. 1961)

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ALL PARTIES TO AN OIL AND GAS UNITIZATION AGREEMENT NOT INDISPENSABLE TO A SUIT TO CANCEL A LEASE IN THE UNIT.—Plaintiff executed an oil and gas lease with defendant, as lessee, providing for a primary term of three years, subject to a right of the lessee to extend the term of the lease if he drilled a commercial well below 2,000 feet during the primary term. The lease also reserved to plaintiff a royalty of one-eighth of the proceeds derived from the sale of all oil or gas produced and authorized the lessee or its assignee to enter into a unit operating agreement pooling the production under the lease with other producers and owners. Expressly contained within this authority was the power to include plaintiff's right to one-eighth of the proceeds from the production of his land in the unit operating agreement. Defendant-Lessee advised plaintiff that a commercial well had been drilled and that he exercised his option to extend the term of the lease. The lease was subsequently assigned by the lessee and the defendant-assignee executed a unit operating agreement covering plaintiff's premises and premises of others who were not joined as parties in this action. Pursuant to this agreement, each title holder who was party to the plan was to share in the production from the unit in the ratio that the number of acres held by him bore to the total number of acres contained in the unit. The agreement further provided that "nothing herein contained shall be construed as affecting or passing title to any lands, leases, or permits, but the Operator shall acquire operating rights only."[1] In an action in the United States District Court for the District of Montana plaintiff demanded cancellation of the lease plus damages, alleging that lessee had drilled no commercial well within the primary term and that the lessee had extended the term of the lease on the basis of false and fraudulent statements. On motion of the defendant, the district court dismissed the action under Rule 12(b) of the Federal Rules of Civil Procedure on the ground that all of the parties to the unit agreement had not been joined and that they were indispensable thereunder.[2] On appeal to the United States Court of Appeals for the Ninth Circuit, *held*, reversed. The parties to a unitization agreement are not necessarily indispensable to a suit to cancel a lease included in such agreement. *Stumpf v. Fidelity Gas Co.*, 294 F.2d 886 (9th Cir. 1961).

A source of confusion on the question of whether or not all parties to a unitization agreement are indispensable to a suit involving a lease thereunder has been the leading case[3] of *Veal v. Thomason*.[4] In that case defendant and other owners executed concurrent leases to the same lessee. Each lease provided for the unitization of the interests of the landowners by a stipulation that all the leases were to be treated as one and that each owner was to share proportionately in the production from the total area. Plaintiff, claiming title to the land leased by defendant, brought an action

[1]Stumpf v. Fidelity Gas Co., 294 F.2d 886, 895 (9th Cir. 1961).

[2]"Indisensable parties are those with such an interest in the controversy that a final decree cannot be entered in their absence without adversely affecting their rights or without leaving the action in a state which would be inconsistent with equity and good conscience." Sechrist v. Palshook, 95 F. Supp. 746, 748 (M.D. Pa. 1951).

[3]Instant case at 888; HOFFMAN, VOLUNTARY POOLING AND UNITIZATION 144 (1954).

[4]138 Tex. 341, 159 S.W.2d 472 (1942).

in trespass to try title[5] and included a count to set aside a sale of the land to defendant under a deed of trust. On motion of the defendant the suit was dismissed, the court holding that the owners of the lands in the unit were indispensable parties. The Supreme Court of Texas affirmed, reasoning that the absent parties were indispensable because a decision in favor of the plaintiff would free the land from the lease and remove it from the unit, thus destroying the royalty interest in the land held by the other owners in the unit block without affording them their day in court. In dictum, the court said that the effect of the unitization was to "vest all the lessors of land in the unitized block with joint ownership of the royalty earned from all the land in such block."[6] The court then noted with approval cases holding that in Texas royalty is a real property interest.[7] An outgrowth of this dictum is the theory of "reciprocal conveyancing,"[8] under which the effect of unitization to vest all lessors therein with joint ownership of the royalty (which is considered an interest in real property) necessitates the conclusion that by joining the unit, each lessor conveys an estate in his land to every other lessor in the unit.[9] This dictum has been criticized as unnecessarily complicating the *party* problem in suits involving unitization agreements,[10] and in the more recent decisions, Texas courts have reduced the significance of the doctrine.[11] A majority of the jurisdictions outside of Texas do not subscribe to the theory of reciprocal conveyancing[12] and should not encounter any problem with respect to the issue of indispensible parties where a stranger to the unitization agreement seeks only to substitute himself in place of one of the parties to the agreement.

The reciprocal conveyancing theory expressed in the *Veal*[13] case has resulted in *Veal* being cited as holding that all parties to a unitization agreement are indispensable in suits involving leases in a unit block,[14] and

[5]"All fictitious proceedings in the action of ejectment are abolished. The method of trying titles to lands, tenements or other real property shall be by action of trespass to try title." ANN. CIV. ST. TEX., art. 7364 (Vernon 1960). An action to try title to declare a mineral lease terminated was not a suit for cancellation though its effect was the same. Dennis v. Royal Petroleum Corp., 326 S.W.2d 538, 541 (Tex. Civ. App. 1959).

[6]159 S.W.2d at 476 (Tex. 1942).

[7]The court cited the following cases (159 S.W.2d at 476) ; Sheffield v. Hogg (Federal Royalty Co. v. State), 124 Tex. 290, 77 S.W.2d 1021, 80 S.W.2d 741 (1934) ; Sheppard v. Stanolind Oil & Gas Co., 125 S.W.2d 543 (Tex. Civ. App. 1939) ; W. T. Waggoner Estate v. Sigler Oil Co., 118 Tex. 593, 19 S.W.2d 27 (1929) ; State National Bank of Corpus Christi v. Morgan, 135 Tex. 509, 143 S.W.2d 757 (1940) ; O'Connor v. Quintana Petroleum Co., 134 Tex. 179, 133 S.W.2d 112, 134 S.W.2d 1016 (1939).

[8]Instant case at 895; Dedman, *Indispensable Parties in Pooling Cases*, 9 Sw. L.J. 27, 39 (1955).

[9]Hoffman, *op. cit. supra* note 4, at 146; Dedman, *op cit. supra* note 9.

[10]Dedman, *supra* note 9, at 83.

[11]Sohio Petroleum Co. v. Jurek, 248 S.W.2d 294 (Tex. Civ. App. 1952) ; *Cf.* Fussell v. Rinque, 269 S.W.2d 442 (Tex. Civ. App. 1954) ; Gehrke v. State, 315 S.W.2d 684 (Tex. Civ. App. 1958).

[12]Phillips Petroleum Co. v. Peterson, 218 F.2d 926 (10th Cir. 1954) ; See Kenoyer v. Magnolia Petroleum Co., 173 Kan. 183, 245 P.2d 176 (1952) ; Coolbaugh v. Lehigh & Wilkes-Barre Coal Co., 218 Pa. 320, 67 Atl. 615 (1907) ; Shell Petroleum Corp. v. Calcasieu Real Estate & Oil Co., 185 La. 751, 170 So. 785 (1936) ; Lynch v. Davis, 79 W.Va. 437, 92 S.E. 427 (1917) ; Arkansas Louisiana Gas Co. v. Southwest Natural Production Co., 221 La. 608, 60 So. 2d 9 (1952).

[13]138 Tex. 341, 159 S.W.2d 472 (1942).

[14]Belt v. Texas Co., 175 S.W.2d 622 (Tex. Civ. App. 1943) ; Whelan v. Placid Oil Co., 198 F.2d 39 (5th Cir. 1952) ; Hudson v. Newell, 172 F2d 848 (5th Cir. 1949) ; Rogers National Bank of Jefferson v. Pewitt, 231 S.W.2d 487 (Tex. Civ. App. 1950),

even in several cases where the doctrine of reciprocal conveyancing does not appear to be relevant to the decision of the particular case.[15]

One writer has stated that such decisions result from a misunderstanding by both courts and lawyers as to the holding of the *Veal* case. This misunderstanding has proceeded to the point where:

> . . . it is generally regarded now that any time pooling or unitization is even mentioned in a lawsuit that every party remotely interested in such pooling or unitization is an indispensable party to the suit, and that the suit cannot proceed without his joinder.[16]

The notion that in suits involving leases under a unitization agreement all parties to the agreement are indispensable has been properly criticized as causing extreme hardship and injustice to lessors who may have good cause to have their leases cancelled.[17] This was recognized by the court in the instant case:[18]

> If the mere fact of the execution of the unitization agreement makes all parties interested in it indispensable, then it is obvious from the facts shown in this record that no matter how right plaintiff may be as to the facts alleged in his complaint, he is denied access to the courts, both federal and state. Some of those parties listed in the motion which the court sustained are shown to be residents of Montana and joining them would oust the court of jurisdiction. And as a practical matter, some of them are shown to be deceased, and probably the determination of who are all the parties interested in the unit agreement would be beyond the means of an ordinary litigant. Nor does it appear that he could gain access to the state courts for many of these parties are shown to be non-residents of the state and it may be presumed unavailable there.

In reaching its decision the court in the instant case distinguished *Veal v. Thomason*[19] on two points. First, the theory of reciprocal conveyancing was not applicable to the instant case because a clause in the unitization agreement expressly stated that the agreement should not be construed as passing any title to land.[20] Therefore, the other members of the unit had no estate in the leased premises owned by the plaintiff; their sole interest was a contract right to a portion of the proceeds.[21]

[15]An illustration of this misapplication is *Whelan v. Placid Oil Co.*, 198 F.2d 39 (5th Cir. 1952), which involved a controversy between two adverse lessee claimants who claimed through a common lessor. Plaintiff, subsequent to the execution of his lease, included it in a unitization agreement and the court held that all parties to the agreement were indispensable because under *Veal v. Tomason*, 138 Tex. 341, 159 S.W.2d 472 (1942), all of the members of the unit by virtue of the unitization acquired an interest in the mineral estate of the land in question. It is submitted that the case is not sound because the validity of the unitization agreement was not dependent on the lease inasmuch as they were separate instruments. Thus, any decree affecting the lease would not affect the interests of the other owners in the unit.

[16]Dedman, *supra* note 9, at 56.

[17]*Id.* at 43.

[18]Instant case at 891.

[19]138 Tex. 341, 159 S.W.2d 472 (1942).

[20]Instant case at 895.

[21]In HOFFMAN, VOLUNTARY POOLING AND UNITIZATION 149-153 (1954) the author poses a hypothetical situation whereby A, B, C, and D have each leased tracts of equal acreage to the same lessee, and each has then joined in an agreement pooling all of

Secondly, the court noted that in the *Veal* case the execution of the community lease effected the unitization of the lands in the lease. Thus, the lease and the unit operating agreement were one and the same thing. On the other hand, in the instant case the plaintiff-lessor executed a separate lease with the defendant-lessee and the unitization was accomplished in a later instrument encompassing an agreement to which plaintiff was not a party. This case, then, involved two separate contracts: (1) the lease executed by plaintiff to defendant-lessee and (2) the unitization agreement executed thereafter by defendant-assignee.

The court stated that under the pleadings plaintiff was not asking for any relief with respect to the unitization agreement.[22] However, the court said that even assuming the plaintiff was requesting relief in connection therewih, and assuming, but not deciding, that such relief could not be granted without joining all the parties to the agreement, under Rule 19(b), Federal Rules of Civil Procedure,[23] the court would not be precluded from granting relief between such parties as were before the court which would not affect the rights of the absent parties. In the instant case such relief would be cancellation of the lease and damages.

The distinction is valid considering that (1) the court, under Rule 19(b), has the power to grant a portion of the relief even if the entire prayer for relief cannot be granted and (2) the facts of this case present a situation where Rule 19(b) is applicable. In the *Veal* case it would have been impossible to remove Veal's land from the community lease without removing it from the unit operating agreement because they were one and the same. However, the situation presented in the instant case is such that the separate character of the lease and the unitization agreement makes it possible to cancel the lease without holding that the land which was sub-

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the tracts. Under the theory of reciprocal conveyancing the result of the unitization of the tracts is that A, who owned all of the royalty interest in his tract after the lease but before the unitization agreement, now owns only one-fourth of the royalty interest in his land, the other three-fourths now belonging to B, C, and D. However, A owns one-fourth of the royalty interest in the land of B, C, and D respectively. If X, a stranger to the lease and pooling, has a valid claim to the land leased by A, the author states that X can sue A without joining B, C, and D and can recover A's one-fourth interest in the royalty from the tract in question; however, X cannot sue A alone and recover A's interest in one-fourth of the royalty interest in the tracts of B, C, and D because they were acquired from owners with perfect title. This position appears to be incorrect for the reason that if the total royalty interest in A's tract is owned jointly by A, B, C, and D and X can bring an action to substitute himself for A, as owner of the interest owned by A, without joining B, C, and D, there is no reason why X cannot recover A's interest in the royalty interests in the lands owned by B, C, and D since these royalty interests are also owned jointly by A, B, C, and D. If one-fourth of the royalty interests in the lands of B, C, and D was conveyed to A instead of X because A held himself out as owner of the land he entered in the pool when X, in fact, was owner, X should be able to recover these royalty interests from A.

[22]Nothing in the complaint expressly questioned the validity of the unit agreement as it affected the plaintiff. However, the reply contained language alleging that the inclusion of the lease in the unit agreement was void. The court, however, did not consider this to be an attack on the unitization agreement. Instant case at 890.

[23]". . . The court in its discretion may proceed in the action without making such persons parties, if its jurisdiction over them as to either service of process or venue can be acquired only by their consent or voluntary appearance or if, though they are subject to its jurisdiction their joinder would deprive the court of jurisdiction of the parties before it; but the judgment rendered therein does not affect the rights or liabilities of absent persons."

ject to it is no longer subject to the unit operating agreement. As stated by the court, the only rights which would be affected relate to the manner of dividing the distributive share of the proceeds from the entire unit operation which were allocable to plaintiff's land. All of the parties whose rights could be affected on this point were joined as parties. In this case an adjudication in favor of the plaintiff would result in his receiving 100% of the share attributable to his land instead of one-eighth thereof; defendant-assignee would lose his right to receive seven-eighths of this distributive share, but he is a party to the proceeding and will have his day in court. The right to extract from the land would not be affected; therefore, neither the operator nor the parties to the unit agreement could be heard to complain.[24]

It should be noted that in a few cases it has been held that if the plaintiff in a suit involving unitized land expressly ratifies the unitization agreement, he can proceed without joining all the members of the unit.[25] The instant case, however, goes beyond these cases in holding that even if plaintiff does not expressly ratify the unitization agreement, he is not precluded from obtaining relief in respect to the validity of the lease as between himself and the other parties before the court, and the court goes still further and states that even if he attacks the agreement, the court could give limited relief hereinbefore described.

While the *Veal* case, then, is not discarded as authority by *Stumpf*,[26] it is closely and appropriately limited to its facts. Although *Stumpf* dealt with a situation where the unitization agreement and the lease were accomplished in separate instruments, it may very well be applicable to cases where the lease and the unitization agreement are contained in one instrument, if they are separable (*i.e.*, if lease rights may be changed without affecting rights of other parties to the unitization agreement). The decision of the instant case is an indication that courts are becoming aware of the confusion and injustice which have resulted from an indiscriminate application of the rule in the *Veal* case to factual situations not requiring its application and are beginning to limit the rule to the fates of that case. The perceptive distinction in *Stumpf* should provide a basis for adjudicating the rights between lessors and lessees, even where the lands have been incorporated into a unit oprating agreement, without imposing unnecessary and perhaps impossible burdens on the parties.

STEPHEN H. FOSTER

[24]In denying defendants' petition for rehearing, the court said that cancellation of the lease could not be effected until after December 27, 1955, the date plaintiff received notice of the default. Therefore, the lease giving the authority to enter the unitization agreement was in effect at the time defendant-assignee executed the unitization agreement, and cancellation of the lease could not affect the unitization agreement. Instant case at 897.

[25]Hutchins v. Birdsong, 258 S.W.2d 218 (Tex. Civ. App. 1953); Fussell v. Rinque, 269 S.W.2d 442 (Tex. Civ. App. 1954); Hudson v. Newell, 174 F.2d 546 (5th Cir. 1949); Gehrke v. State, 315 S.W.2d 684 (Tex Civ. App. 1958).

[26]Instant case.