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James Muenker

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Oil and Gas: *Roye Realty & Developing v. Watson* — An Answer to the Take-or-Pay Royalty Issue in Oklahoma or Simply More Confusion?

I. Introduction

The oil and gas industry is, by now, well aware of the issues surrounding take-or-pay gas contracts and the historical practices that spawned numerous lawsuits since 1982. First sparked by declining economic conditions in the natural gas market, pipeline companies were forced to default on take-or-pay contracts with natural gas producers, exposing themselves to billions of dollars of liability. The settlement of a majority of these lawsuits has generated its own litigation, with royalty owners asserting a right to settlement proceeds. During the last decade, much has been written regarding royalty owners' rights to receive a portion of the proceeds under take-or-pay contracts, and, until recently, most of the discussion was mere speculation based on a handful of cases that failed to adequately resolve many questions.¹ However, in the past year, several jurisdictions handed down decisions involving take-or-pay settlements.² This, in turn, will likely be the subject of even more articles.

This note examines the recent decision by the Oklahoma Supreme Court in *Roye Realty & Developing, Inc. v. Watson*.³ The closely divided court held in a five-to-four decision that royalty owners are not entitled to share in take-or-pay payments absent clear language in the oil and gas lease expressing a contrary intent.⁴ Courts and commentators have devoted a considerable amount of time examining the early cases involving take-or-pay settlements, and this author wishes to avoid merely restating the opinions of those who came before. However, a brief sojourn into the

1. See, e.g., John S. Lowe, *Defining the Royalty Obligation*, 49 SMU L. REV. 223 (1996); Ryan E. Griffiths, Comment, *Roye Realty & Developing, Inc. v. Arkla, Inc.: Two Steps Forward and Two Steps Back in the Take-Or-Pay Saga*, 20 OKLA. CITY U. L. REV. 219 (1995); Patricia A. Brown, Note, *Klein v. Jones: Equitable Right to Royalties on Take-or-Pay Settlements*, 47 ARK. L. REV. 749 (1994); Kirk J. Bily, Comment, *Royalty on Take-or-Pay Payments and Related Consideration Accruing to Producers*, 27 HOUS. L. REV. 105 (1990); Angela Jeanne Crowder, Comment, *Take-or-Pay Payments and Settlements — Does the Landowner Share?*, 49 LA. L. REV. 921 (1989).

2. See, e.g., *Harvey E. Yates Co. v. Powell*, 98 F.3d 1222, 1236-37 (10th Cir. 1996) (interpreting New Mexico law and holding that State as lessor was not entitled to royalty payment on take-or-pay settlement proceeds unless proceeds were ultimately recouped in exchange for actual production); *Independent Petroleum Ass'n v. Babbitt*, 92 F.3d 1248, 1260 (D.C. Cir. 1996) (invalidating Department of Interior policy decision to collect royalties on take-or-pay settlement buyout payment); *Williamson v. Elf Aquitaine, Inc.*, 925 F. Supp. 1163, 1169 (N.D. Miss. 1996) (applying Mississippi law and holding that nonrecoupable cash settlement of take-or-pay dispute was subject to royalty payment obligation); *Transamerica Natural Gas Corp. v. Finkelstein*, 933 S.W.2d 591, 600 (Tex. App.—San Antonio 1996, n.w.h.) (rejecting unjust enrichment claim for royalty on take-or-pay settlement monies).

3. No. 76848, 1996 WL 515794 (Okla. Sept. 10, 1996).

4. See *id.* at *9.

industry's historical practices is necessary to understand the context in which this case arose. As such, this note will briefly review the economic and regulatory environment that gave rise to the take-or-pay problem, and the first cases to decide a royalty owner's right to share in settlement proceeds. Second, this note will review the legal framework from which the early decisions arose and the fundamental differences between the jurisdictions in interpreting oil and gas leases. Finally, this note will analyze the *Roye Realty* court's opinion in light of Oklahoma interpretative principles as applied to other provisions of the oil and gas lease.

II. Industry Background

A. History of the Take-or-Pay Wars

In the early stages of the modern natural gas industry, producers had little or no incentive to make the capital expenditures necessary to drill a well. Given the incipient state of the market, producers had no assurance of sales sufficient to maintain their leases.⁵ Early gas contract provisions requiring pipeline companies to take a certain quantity of gas were of relatively little value. If the pipeline breached the contract only to take at a later date, the damages for such breach could potentially be limited to the time value of the money that would have been received by performance of the contract.⁶

Historically, pipeline companies have occupied a merchant role in the industry. In other words, they purchased from the producers and resold to public utilities and industrial users who required large amounts of natural gas. Consequently, pipelines desired to enter into long-term purchase contracts with producers to secure an adequate supply for their customers.⁷ Virtually all of these long-term contracts drafted in the 1970s contained take-or-pay provisions,⁸ requiring the pipeline to take a minimum quantity of gas on an annual basis or pay the producer the difference between the amount actually taken and the amount required under the contract.⁹

5. See Paul Strohl, *Hard Times, Settling the Take-or-Pay Claim: The Producer's Perspective*, 3 NAT. RESOURCES & ENV'T 11, 11 (1989).

6. See *id.*

7. See Michael P. Pearson & Richard D. Watt, *To Share or Not to Share: Royalty Obligations Arising out of Take-or-Pay or Similar Gas Contract Litigation*, 42 INST. ON OIL & GAS L. & TAX'N § 14.01, § 14.02[1], at 14-5 (1991).

8. A sample take-or-pay clause is as follows:

Subject to the other terms and provisions of this Agreement, Seller agrees to sell to Buyer, and Buyer agrees to purchase and take delivery thereof from Seller, or pay for if made available hereunder but not taken, a Minimum Annual Contract Quantity of Gas during the term hereof equal to eighty percent (80%) of Seller's Maximum Deliverability from each well subject to this Agreement.

Id. at 14-6 n.4.

9. An oft-quoted definition of a take-or-pay clause is as follows:

A clause in a Gas Purchase Contract . . . requiring the purchaser to take, or failing to take, to pay for the minimum annual contract volume of gas which the producer-seller has available for delivery. Under such clause the purchaser usually has the right to take the gas paid for (but undelivered) in succeeding years.

8 HOWARD R. WILLIAMS & CHARLES J. MEYERS, OIL AND GAS LAW 1099 (1996).

This mutually beneficial practice encouraged producers to enter into leases and develop natural gas wells, knowing that there would be a market for the gas produced, and guaranteed the pipelines an adequate supply of gas to meet the market demand.

A majority of these contracts provided the pipeline a period of time to make up any deficiencies for gas paid but not taken. In most cases, the pipeline would have the right through so-called "recoupment provisions" to credit gas taken in excess of the minimum contract amount against previous take-or-pay payments. The gas taken under these provisions is commonly referred to as "make-up gas." This arrangement worked well for both pipeline and producer while rates were increasing; unfortunately, however, the industry failed to anticipate future economic and regulatory conditions that would eventually result in a sharp decline in prices and a restructuring of the marketplace.

Beginning in the early 1970s, the United States experienced significant shortages of natural gas, prompting the Federal Power Commission (FPC) and Congress to drastically change the way the natural gas industry was regulated.¹⁰ Following the passing of the Natural Gas Policy Act of 1978 (NGPA),¹¹ exploration and production significantly increased, and by 1982,¹² there was an excess supply of natural gas. Yet, pipelines found themselves bound to expensive, long-term gas contracts in a market where they could not recover their purchase costs through subsequent sales.¹³

Facing bankruptcy, pipeline companies were forced to attempt to renegotiate their gas contracts with producers or, in most cases, simply discontinue the take-or-pay payments and refuse to take any more gas.¹⁴ Naturally, the producers filed suit for breach of contract. At first, pipelines asserted a variety of defenses in an attempt to avoid the gas contracts, including force majeure and commercial impracticability.¹⁵ The pipelines' efforts to avoid the contracts largely failed,¹⁶ and,

10. Historically, the oil and gas industry was subject to dual regulatory conditions in the interstate and intrastate markets. The United States Supreme Court case of *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954), had rendered interstate wellhead sales of natural gas to pipelines subject to FPC rate regulation. Pipelines operating solely within the boundaries of an individual state, however, were not subject to these rate regulations. As such, there was little incentive for intrastate producers to enter the interstate market where their profits were limited.

11. Pub. L. No. 95-621, 92 Stat. 3350 (codified as amended at 15 U.S.C. §§ 3301-3432 (1994)).

12. The NGPA phased out the historical distinction between the interstate and intrastate markets, and encouraged exploration for new reserves by establishing incentive ceiling prices. See Pearson & Watt, *supra* note 7, at 14-8.

13. See Bruce M. Kramer, *Liability to Royalty Owners for Proceeds From Take-or-Pay and Settlement Payments*, 15 E. MIN. L. FOUND. § 14.01 (1994).

14. See *id.*

15. Pipelines have claimed that economic recessions, falling prices, mild winters, and federal regulations are all events beyond their control that fall within their force majeure contract provision. Likewise, pipelines argue these events make it commercially impractical to perform. However, these events are merely foreseeable risks — performance under the contract is still possible, just not profitable. For a detailed discussion of these defenses and cases rejecting them, see John Burritt McArthur, *The Take-or-Pay Crisis: Diagnosis, Treatment, and Cure for Immorality in the Marketplace*, 22 N.M. L. REV. 353 (1992).

16. See, e.g., *Kaiser-Francis Oil Co. v. Producer's Gas Co.*, 870 F.2d 563, 566 (10th Cir. 1989);

coupled with initiatives passed by the Federal Energy Regulatory Commission (FERC),¹⁷ successor to the FPC, the pipelines felt pressure to settle the billions of dollars of claims facing them.¹⁸ Following the resolution of these lawsuits between producers and pipelines, the industry may very well have thought the take-or-pay wars were over. To the contrary, they had just begun, as royalty owners marched into court demanding a portion of the settlement proceeds.

B. The Early Decisions

Two early decisions by the Fifth Circuit Court of Appeals and the Supreme Court of Wyoming in 1988 set the stage for royalty owner and producer arguments regarding royalty payments on take-or-pay proceeds. In *State v. Pennzoil Co.*,¹⁹ the Wyoming Supreme Court considered whether the lessor of an oil and gas lease was entitled to take-or-pay payments made to the lessee by a gas purchaser. The lessor in *Pennzoil* was the State of Wyoming, who had entered into the lease through the State's Board of Land Commissioners. The Board argued, in part, that the royalty provision in the lease was ambiguous, that the take-or-pay payments were made for future production of gas, and that an advance royalty on that production was proper to serve the intent of the parties.²⁰

The *Pennzoil* court rejected the Board's arguments, instead relying on common-law oil and gas concepts to interpret the royalty provision. The court held that there must be production and a subsequent sale of gas to trigger an obligation to pay royalties.²¹ The court relied on decisions interpreting the habendum clause²² in oil and gas leases, finding that there must be severance of the mineral from the ground to satisfy the "production" requirement.²³ The court additionally rejected the argument that a "sale" of gas could be satisfied by the execution of gas purchase

Universal Resources Corp. v. Panhandle Eastern Pipe Line Co., 813 F.2d 77, 79-80 (5th Cir. 1987).

17. F.E.R.C. Order No. 380, 49 Fed. Reg. 22, 778 (1984) was the first of several orders regulating the way pipelines calculated costs and applied for certificates authorizing transportation services. See Pearson & Watt, *supra* note 7, at 14-11 to 14-16.

18. While the statistics on total payments on take-or-pay settlements differ, one source reported that as of October 31, 1991, interstate pipelines had paid \$9.1 billion to producers on gas purchase contracts. See Donald F. Santa, Jr. & Patricia J. Beneke, *Federal Natural Gas Policy and the Energy Policy Act of 1992*, 14 ENERGY L.J. 1, 8 n.49 (1993).

19. 752 P.2d 975 (Wyo. 1988).

20. See *id.* at 976.

21. See *id.* at 981. The royalty clause contained in the lease at issue was typical of royalty clauses used in the industry and provided for royalties to be paid:

(ii) on gas, including casinghead gas or other hydrocarbon substance, *produced from said land saved and sold or used off the premises* or in the manufacture of gasoline or other products therefrom, the market value at the well of one-eighth of the gas so sold or used, provided that on gas sold at the wells the royalty shall be one-eighth of the *amount realized from such sale*.

Id. at 976.

22. The purpose of the habendum clause is to describe the duration of the interests granted in the oil and gas lease. See 2 EUGENE O. KUNTZ, A TREATISE ON THE LAW OF OIL & GAS § 26.1, at 318 (1989).

23. See *Pennzoil*, 752 P.2d at 979.

contracts, finding instead that “sale” requires a transfer of title in the gas.²⁴ Without severing the gas from the ground (production), the producer had yet to gain an interest in the gas which they could transfer to the pipeline. After concluding there was no production and, consequently, no sale, the *Pennzoil* court denied the lessor any royalty on the take-or-pay payments.²⁵

Likewise, the Fifth Circuit Court of Appeals, in *Diamond Shamrock Exploration Co. v. Hodel*,²⁶ also rejected a lessor's argument that the term “production” in the leases at issue should be given a broad reading, thereby entitling the lessor to royalty on take-or-pay payments. The *Diamond Shamrock* lessor was the federal government,²⁷ and interpretation of the lease agreements required application of several federal statutes, including the Outer Continental Shelf Lands Act (OCSLA)²⁸ and the Mineral Lands Leasing Act (MLLA).²⁹ The court defined the term “production” to mean the actual physical severance of the minerals from the ground.³⁰ In rejecting the argument that take-or-pay payments should be included in the “value of production,” the court found an important distinction between payments for the purchase of gas and take-or-pay payments for the pipeline's failure to purchase the gas.³¹ As such, the court concluded that the payments were merely intended to compensate the producer for the risks inherent in developing the gas and did not represent a part of the price paid for the gas.³²

While these two decisions represent the beginning of judicial determination of a lessee's obligation to pay royalties on take-or-pay payments, two important distinctions must be made between these decisions and subsequent opinions by courts interpreting leases between private individuals. First, the lessors in *Pennzoil* and *Diamond Shamrock* were both governmental entities who were responsible for drafting the leases at issue. The importance of this fact cannot be overstated, as a fundamental principle in construing oil and gas leases requires that the document should be construed against the drafting party.³³ The application of this principle usually results in the lease being construed against the lessee, in that most leases are drafted by oil company-lessees and not by mineral owner-lessors.³⁴ However, this was not the case in either *Pennzoil* or *Diamond Shamrock*, where the lessors drafted the leases and then asked the courts for an expansive reading of the document which would entitle them to increased royalty payments. Second, the lessors sought a royalty share of take-or-pay payments, not take-or-pay settlement proceeds,

24. *See id.* at 979-80.

25. *See id.* at 980.

26. 853 F.2d 1159 (5th Cir. 1988).

27. The lessor in *Diamond Shamrock* was the United States Department of the Interior (DOI). *See id.* at 1161.

28. Ch. 345, 67 Stat. 462 (1953) (codified as amended at 43 U.S.C. §§ 1331-1356 (1994)).

29. Ch. 85, 41 Stat. 437 (1920) (codified as amended at 30 U.S.C. §§ 181-287 (1994)).

30. *See Diamond Shamrock*, 853 F.2d at 1168.

31. *See id.* at 1167.

32. *See id.* at 1167-68.

33. *See, e.g., Probst v. Ingram*, 373 P.2d 58 (Okla. 1962); *Simon v. Foster*, 373 P.2d 28 (Okla. 1962). *See generally* Lowe, *supra* note 1.

34. *See Klein v. Jones*, 980 F.2d 521, 531 (8th Cir. 1992) (applying Arkansas law).

leaving some commentators to theorize that royalties may still be due on settlement payments under the lessee's implied duty to market the gas.³⁵

C. *The Development of Take-or-Pay Case Law*

Texas appellate courts were the first to consider a royalty owner's rights to take-or-pay settlements. In *Killam Oil Co. v. Bruni*³⁶ (*Bruni I*), an oil and gas lessor who was responsible for drafting the lease brought suit against lessees seeking a royalty share of proceeds received under a take-or-pay settlement. The lessor alleged a breach of marketing duty, breach of duty of good faith and fair dealing, conversion, fraud, and also argued the take-or-pay provisions constituted a constructive sale of the gas. The court applied principles of law enunciated in cases construing royalty clauses of oil and gas leases,³⁷ holding that as a matter of law no royalties are due on take-or-pay settlement proceeds.³⁸ In reaching its conclusion, the court relied heavily on the established definition of the term "production" in Texas as meaning the actual physical extraction of the mineral from the soil.³⁹ The court noted:

[The lessors], as drafters of the lease, could have specifically included a provision allowing for royalties to be paid upon proceeds received . . . from settlements of disputes arising from a breach of take-or-pay provisions in gas contracts. . . . [T]he [lessor] unambiguously limited its right to royalty payments only from gas actually extracted from the land.⁴⁰

On subsequent appeal, in *Hurd Enterprises, Ltd. v. Bruni*⁴¹ (*Bruni II*), the court affirmed its earlier decision by the "law of the case" doctrine.⁴²

Royalty owners in Texas tried a different approach to recover take-or-pay proceeds in *Mandell v. Hamman Oil & Refining Co.*⁴³ Following a settlement between lessee and the Tennessee pipeline company on a take-or-pay gas contract, royalty owners argued they were entitled to the proceeds as either a party or third-

35. For a detailed discussion on the implied covenant to market, see Randy King, *Royalty Owner Claims to Take-or-Pay Payments Under the Implied Covenant to Market and the Duty of Good Faith and Fair Dealing*, 33 S. TEX. L.J. 801 (1992).

36. 806 S.W.2d 264 (Tex. App.—San Antonio 1991, writ denied).

37. The court relied on *Gulf Oil Corp. v. Reid*, 337 S.W.2d 267 (Tex. 1960), *Monsanto Co. v. Tyrrell*, 537 S.W.2d 135 (Tex. Civ. App.—Houston [14th Dist.] 1976, writ ref'd n.r.e.), and *Exxon Corp. v. Middleton*, 613 S.W.2d 240 (Tex. 1981).

38. See *Killam*, 805 S.W.2d at 268.

39. See *id.* at 267.

40. *Id.* at 267-68.

41. 828 S.W.2d 101 (Tex. App.—San Antonio 1992, writ denied).

42. The "law of the case" doctrine refers to the principle by which questions of law decided on appeal to a court of last resort governs the case throughout its subsequent decisions. See *id.* at 106 n.7. It was employed in *Bruni II* to avoid reconsidering the royalty owners rights in light of the Fifth Circuit Court of Appeals decision in *Frey v. Amoco Prod. Co.*, 943 F.2d 578 (5th Cir. 1991), *opinion reinstated in part on reh'g*, 976 P.2d 242 (5th Cir. 1992), which was handed down between *Bruni I* and *Bruni II*.

43. 822 S.W.2d 153 (Tex. App.—Houston [1st Dist.] 1991, writ denied).

party beneficiary to the gas contract, and under the lessee's duty to market the gas. The court found in favor of the lessee, holding that take or pay is not a benefit associated with execution of a lease, nor does it flow from the implied covenant to market gas.⁴⁴ In so holding, the *Mandell* court relied on the Fifth Circuit's *Diamond Shamrock* decision, as well as *Bruni I*, in determining that take or pay is not a payment for production, but for nonproduction.⁴⁵ In recognizing that production is the key to royalty, occurring only upon physical severance from the ground, the court held that take-or-pay payments made before gas is produced does not constitute a payment for the sale of gas.⁴⁶ Finally, the court rejected the implied marketing covenant argument, holding that the duty to market only relates to gas actually produced.⁴⁷

The development of case law in Arkansas and Louisiana has taken a markedly different path. Beginning with *Frey v. Amoco Production Co.*,⁴⁸ the Fifth Circuit Court of Appeals deviated from its prior holding in *Diamond Shamrock* and held that under Louisiana law⁴⁹ and the terms of the lease before it,⁵⁰ royalty was owed on take-or-pay payments.⁵¹ The court relied on Louisiana's interpretation of an oil and gas lease as equivalent to a cooperative venture,⁵² whereby the lessor contributes land in return for a share of the economic benefits anticipated from the lease. The court distinguished its holding in *Diamond Shamrock* on three grounds. First, the leases contained different lease language.⁵³ Second, the *Diamond*

44. *See id.* at 165.

45. *See id.* at 164.

46. *See id.* at 165.

47. *See id.* at 164.

48. 943 F.2d 578 (5th Cir. 1991), *opinion reinstated in part on reh'g*, 976 F.2d 242 (5th Cir. 1992).

49. The Court of Appeals certified the following question to the Louisiana Supreme Court: Whether under Louisiana law and the facts concerning the Lease executed by Amoco and Frey, the Lease's clause that provides Frey a "royalty on gas sold by the Lessee of one-fifth (1/5) of the amount realized at the well from such sales" requires Amoco to pay Frey a royalty share of the take-or-pay payments that Amoco earns as a result of having executed the Lease and under the terms of a gas sales contract with a pipeline-purchaser.

Frey, 951 F.2d at 68. The Louisiana Supreme Court answered in the affirmative. *See Frey v. Amoco Prod. Co.*, 603 So. 2d 166, 177 (La. 1992).

50. The lease royalty clause provided for royalties on "gas sold by Lessee [at] one-fifth (1/5) of the amount realized at the well from such sales." *Frey*, 943 F.2d at 580 (alteration in original).

51. *See id.* at 584-86.

52. In *Henry v. Ballard & Cordell Corp.*, 418 So. 2d 1334 (La. 1982), the court reasoned: Where the mineral lease provides for payment to the lessor of a fractional royalty interest, the lease arrangement is in the nature of a cooperative venture: the lessor contributes the land and the less the capital and expertise necessary to develop the minerals for the mutual benefit of both parties.

Henry, 418 So. 2d at 1338. The court cited with approval Professor Harrell's statement that: any determination of the market value of gas which . . . permits either the lessor or lessee to receive a part of the gross revenues from the property greater than the fractional division contemplated by the lease, should be considered inherently contrary to the basic nature of the lease and be sustained only in the clearest of cases.

Id. at 1338 n.10 (quoting Thomas Harrell, *Developments in Non-Regulatory Oil & Gas Law*, 30 INST. ON OIL & GAS L. & TAX'N 311, 336 (1979)).

53. The *Diamond Shamrock* lease called for royalty payable on "amount or value of production

Shamrock decision was based on federal law, while *Frey* concerned application of Louisiana law.⁵⁴ Finally, the lessor drafted the lease in *Diamond Shamrock*, whereas the lessee prepared the lease in *Frey*.⁵⁵

The court concluded that if lessors did not share in take-or-pay payments, lessees would have an incentive to adjust prices under their contracts in return for settlements with pipelines.⁵⁶ Those take-or-pay payments represented economic benefits derived from the right to take gas from the premises, a right granted by the lease.⁵⁷ The court found it would be inequitable to allow those benefits to accrue exclusively to the lessee.⁵⁸

The Eighth Circuit Court of Appeals employed similar logic in arriving at its decision in *Klein v. Jones*.⁵⁹ In *Klein*, royalty owners⁶⁰ sought payments with respect to take-or-pay settlement proceeds, alleging in part that they were third-party beneficiaries to the gas purchase contracts and that the doctrine of unjust enrichment warranted the court's intervention. The court rejected the lessor's third-party beneficiary theory but agreed that intervention was necessary under equitable principles.⁶¹ Relying on Harrell's view that a lease arrangement is a cooperative venture⁶² and the Fifth Circuit's decision in *Frey*, the court agreed that the royalty owners were entitled to a share of the take-or-pay settlement proceeds.⁶³

The most recent decision by a United States Circuit Court of Appeals addressing this issue is *Harvey E. Yates Co. v. Powell*.⁶⁴ In *Harvey*, the Tenth Circuit denied the State of New Mexico's claim for royalty on take-or-pay settlement proceeds.⁶⁵

saved, removed, or sold" whereas the *Frey* lease calculated royalty on "the amount realized at the well from [the sale of gas]." See *Frey*, 943 F.2d at 581 (alteration and emphasis in original).

54. Among the Louisiana statutes relied on by the court were LA. CIV. CODE ANN. art. 2450 (West 1952) (defining sale); LA. CIV. CODE ANN. art. 2050 (West 1987) (contract interpretation principles); and LA. REV. STAT. ANN. § 31:122 (West 1989) (requiring lessee to perform contract in good faith and act as for mutual benefit of himself and lessor).

55. In Louisiana, contractual ambiguities must be resolved against the drafting party. See LA. CIV. CODE ANN. art. 2056 (West 1987).

56. See *Frey*, 943 F.2d at 585.

57. See *id.* at 584.

58. See *id.*

59. 980 F.2d 521 (8th Cir. 1992).

60. The lease royalty clauses provided:

Lessee shall pay Lessor as royalty on gas, casinghead gas, distillate, condensate, and other gaseous substance produced from said land and sold or used by Lessee off of the land or in the manufacture of gasoline or other products, the market value at the mouth of the wells of one-eighth (1/8) of such products so sold or used. On all gas, casinghead gas, condensate and distillate sold at the wells by the Lessee the royalty shall be one-eighth (1/8) of the amount realized from such sales.

Id. at 525.

61. See *id.* at 526-31.

62. See *supra* note 52.

63. See *Klein*, 980 F.2d at 528-31. The court also relied on Arkansas statutory scheme, finding it analogous to the Louisiana statute's relied on by the Court in *Frey*. See ARK. CODE ANN. § 15-74-705 (Michie 1987) (requiring that lessee protect lessor's interest).

64. 98 F.3d 1222 (10th Cir. 1996).

65. See *id.* at 1237.

The facts in *Harvey* were similar to those in *Diamond Shamrock* and *Pennzoil*, in that the lessor drafted the lease and the court applied the law of jurisdictions requiring actual production to trigger the royalty obligation. However, the *Harvey* court did remand the case for a factual determination as to whether the settlement proceeds were attributable, in part, to a price adjustment for the actual production of gas.⁶⁶

The circuit court decisions, when viewed in relation to the Texas cases, seem to point to the conclusion that jurisdictions employing a "plain terms"⁶⁷ reading to leases would deny royalty on take-or-pay proceeds, whereas jurisdictions who regularly looked beyond the language of the lease, such as courts applying the cooperative venture theory, would allow royalty owners a share of proceeds.⁶⁸ At this point, one would expect Oklahoma to follow the *Frey* and *Klein* opinions, given the fact that Oklahoma, Arkansas, and Louisiana all utilize similar interpretation methods allowing a court to look beyond the lease with regard to market price valuation in gas royalty clauses.⁶⁹ At least one commentator argued that not only was Oklahoma likely to adopt the cooperative venture theory but also that royalty owners might also prevail on a production argument under the plain terms of the lease, in light of Oklahoma decisions rejecting the Texas definition of production.⁷⁰ Such was not the case, however, as the Oklahoma Supreme Court recently held that royalty owners are not entitled to take-or-pay payments.

III. *Roye Realty & Developing, Inc. v. Watson*⁷¹

A. Facts

Roye Realty & Developing, Inc. (Roye), lessee, and R.D. and Dorothy Watson (Watsons), lessors, executed oil and gas leases with a one year primary term covering various lands in Haskell County, Oklahoma. Roye subsequently drilled and completed gas wells capable of producing in paying quantities within the primary term of the leases. Following completion of the wells, Roye entered into a gas purchase agreement with Arkansas Louisiana Gas Company (Arkla), whereby Arkla agreed to purchase a minimum quantity of gas or pay for the difference by means of a typical take-or-pay clause. This purchase agreement was the subject of litigation between Arkla and Roye,⁷² resulting in a confidential settlement agreement between the two parties. Shortly thereafter, the Watsons demanded a share of the settlement proceeds by way of the lease agreement to which Roye

66. *See id.*

67. The phrase "plain terms" is used hereinafter to refer to the lease interpretation method that will not read additional benefits, such as the right to share in take-or-pay proceeds, into the royalty clause.

68. For a thorough discussion of the differences between the plain terms and cooperative venture jurisdictions, see generally Lowe, *supra* note 1.

69. All three jurisdictions follow the *Tara* rule discussed in Part IV of this note.

70. *See King, supra* note 35, at 831.

71. No. 76848, 1996 WL 515794 (Okla. Sept. 10, 1996).

72. *Arkla Energy Resources v. Roye Realty & Developing*, Case No. C-86-67 (Okla. Dist. Ct. settlement agreement dated Feb. 6, 1989).

responded by initiating suit requesting a declaratory judgment defining the rights and liabilities of the respective parties. The Watsons filed an answer, counter-claimed,⁷³ and added Arkla as a third-party defendant.

Roye, Arkla, and the Watsons each filed motions for summary judgment regarding whether the Watsons were entitled to share in the take-or-pay settlement proceeds.⁷⁴ The district court ruled in favor of Roye and Arkla⁷⁵ and denied the Watsons' motion for summary judgment.⁷⁶ The Oklahoma Court of Appeals reversed, holding that Roye effectively marketed the gas by granting Arkla a right to refuse under the take-or-pay provision.⁷⁷ In finding that the trial court's granting of summary judgment was premature, the court of appeals held that the Watsons were entitled to royalties based upon the take-or-pay settlement as a matter of law.⁷⁸ Arkla and Roye petitioned the Oklahoma Supreme Court for certiorari and, after granting certiorari on this first-impression question, the court vacated the court of appeals decision and affirmed the trial court's decision.⁷⁹

B. Decision

Justice Hargrave, in writing for the narrow majority, devoted the majority of the court's opinion to restating the law in surrounding jurisdictions, with little explanation as to why the court chose the particular course of action it did. The court's opening paragraph in discussing royalty owners' rights to take-or-pay settlements discussed the current split among the jurisdictions as follows:

Those jurisdictions favoring the producer rely primarily on a strict interpretation of the language in the leases concerning what constitutes a "sale" and "production", while those jurisdictions finding for the royalty owners have adopted a broader "economic benefit" test based on the lessee's implied covenant to market gas and on unjust enrichment theories.⁸⁰

After providing an overview of the leading cases, which have been previously discussed in Part II of this note, the court moved on to the arguments raised by the parties and the amici curiae.⁸¹

73. The Watsons counterclaimed for breach of contract, failure to pay proceeds from production as required under title 52, section 540 of the Oklahoma Statutes (now 52 OKLA. STAT. § 570.10 (Supp. 1996)), breach of fiduciary duty, declaratory judgment, accounting, third party beneficiary, and punitive damages. See *Roye Realty*, 1996 WL 515794, at *11 n.1.

74. Roye and Arkla additionally filed motions for a protective order, arguing that the Watsons were not entitled to receive a copy of the settlement agreement. This motion was never ruled on. See *Roye Realty*, 1996 WL 515794, at *2.

75. The Oklahoma Supreme Court promptly affirmed the trial court's dismissal of Arkla as a defendant because Arkla had settled with Roye and was not responsible for any monies owed the Watsons. See *id.* at *3 (relying on 52 OKLA. STAT. § 540 (1991)).

76. See *id.* at *2.

77. See *id.* at *3.

78. See *id.*

79. See *id.*

80. *Id.*

81. The importance of the issues presented in this case is evidenced by the numerous amicus curiae

The *Roye Realty* court devoted little time to analyzing the arguments raised by the parties, but instead offered a brief summary. In its motion for summary judgment, Roye argued that the Watsons were not entitled to a portion of the settlement proceeds because the Watsons were not third-party beneficiaries to the gas contract nor was the gas purchase contract incorporated into the leases.⁸² The Watsons argued that they were third-party beneficiaries under the gas purchase contract and that following the settlement, the amount received for the sale of gas significantly decreased.⁸³

The *Roye Realty* court also summarized the arguments contained in the amicus curiae briefs. The briefs on the producer's behalf distinguished the cases holding in favor of royalty owners on the grounds that the royalty clauses in those cases did not require "production."⁸⁴ Additionally, they reasoned that take-or-pay payments were not payments for gas but payments to encourage exploration and reduce the risk faced by the producer.⁸⁵ The briefs in favor of the royalty owner argued that the Watsons were not seeking the enforcement of the royalty clause but the implied covenant to market.⁸⁶ They further argued that the lease should be construed for the mutual economic benefit of both lessor and lessee, entitling the lessor to share in take-or-pay payments.⁸⁷

The *Roye Realty* court needed less than half a page to explain why a royalty owner is not entitled to share in take-or-pay settlements. After reading the royalty clauses, the court noted that royalty was payable on gas produced and sold.⁸⁸ The court defined the word "produced" as meaning not only discovery of the mineral but also its physical extraction from the ground.⁸⁹ The court also found that gas is

briefs filed by the Oklahoma Mineral Owners Association, Oklahoma Independent Petroleum Association, National Association of Royalty Owners and the Oklahoma Chapter of the National Association of Royalty Owners, and Oklahoma-Kansas Mid-Continent Oil & Gas Association.

82. See *Roye Realty*, 1996 WL 515794, at *7.

83. See *id.*

84. See *id.* at *8.

85. See *id.*

86. See *id.*

87. See *id.*

88. See *id.* at *9. There were actually two royalty clauses before the court for interpretation. They provided:

Lessee covenants and agrees to pay lessor as royalty on all oil, condensate, gas, asphalt and other minerals and substances produced, saved and sold from the premises one-eighth of the gross proceeds received from the sale thereof at the mouth of the well, or if not sold at the mouth of the well but sold or used off the premises or for the manufacture of gasoline or any other product, then one-eighth of the market value thereof at the mouth of the well

To pay lessor for gas of whatsoever nature or kind (with all of its constituents) produced and sold or used off the leased premises or used in the manufacture of products therefrom, 25% of the gross proceeds received for the gas sold, used off premises, or in the manufacture of products therefrom, but in no event more than 25% of the actual amount received by the lessee, said payments to be made monthly.

Id. at *9.

89. See *id.*

“sold” when it enters the purchaser’s line.⁹⁰ Although the court recognized that oil and gas leases are to be construed against the lessee and in favor of the lessor, the court found that, absent clear language to the contrary, the intent of the parties did not include sharing take-or-pay settlement proceeds with the royalty owners.⁹¹

IV. Analysis of the Royce Court’s Authority

A. Absence of *Tara Petroleum Corp. v. Hughey*

Noticeably absent from the court’s opinion was any reference to *Tara Petroleum Corp. v. Hughey*,⁹² Oklahoma’s seminal case interpreting “market price” in a gas royalty clause. The issue presented in *Tara* was whether royalties should be calculated using the price established in a gas purchase contract between producer and pipeline, or whether royalty was due based on the current market price. The *Tara* court departed from the majority position, as enunciated by the Texas opinion in *Texas Oil & Gas Corp. v. Vela*.⁹³ The *Vela* court had held that a plain reading of the gas royalty clause renders the contract price irrelevant for purposes of determining royalty payments.⁹⁴

The *Tara* court instead chose to look beyond the provisions of the lease, recognizing that the “necessity of the market” calls for producers to enter into long-term gas purchase contracts.⁹⁵ The court reasoned that basing the royalty payments on fluctuating “current” prices would “not be fair to the producers.”⁹⁶ Finally, the court held that:

The better rule — and the one we adopt — is that when a producer’s lease calls for royalty on gas based on the market price at the well and the producer enters into an arm’s-length, good faith gas purchase contract with the best price and term available to the producer at the time, that price is the “market price” and will discharge the producer’s gas royalty obligation.⁹⁷

Simply put, the *Tara* decision bound royalty owners/lessors to the prices negotiated in these long-term gas contracts between their lessees and the pipeline companies. The practical effect of this decision was the incorporation of the contract price in gas purchase contracts into the oil and gas lease royalty clause.

The *Royce Realty* court’s failure to discuss *Tara* in its decision poses significant precedential concerns when applied to future gas royalty issues, such as marketing incentives and payments made for gas inventory charges.⁹⁸ *Tara* requires an

90. *See id.*

91. *See id.*

92. 630 P.2d 1269 (Okla. 1981).

93. 429 S.W.2d 866 (Tex. 1968).

94. *See id.* at 871.

95. *See Tara*, 630 P.2d at 1273.

96. *Id.*

97. *Id.* (footnotes omitted).

98. One commentator has expressed concern over the precedential effect of take-or-pay settlement

inquiry into the reasonableness of the price negotiated by the lessor in the gas purchase contract. This inquiry necessarily involves a determination of what constitutes the contract price. Such an inquiry may require an examination of those inducements made to the lessee/producer in addition to the gas unit price stated in the contract.

For example, a gas purchase contract providing for a \$1 million advance payment to the producer as an inducement to enter into the contract requiring the delivery of 1 million mcf⁹⁹ of gas at \$3/mcf could have royalty calculated on the \$3 contract price or on \$4/mcf (\$3 contract price + (advance/quantity of gas delivered)). If the lessor could have set a \$4/mcf contract price in lieu of receiving the advance, the application of *Tara* to the preceding example leaves a court with two options. It could either: 1) find the lessee failed to negotiate at arm's length, thereby breaching the obligation to market the gas for the best possible price; or 2) a court could add the advance to the \$3/mcf contract price and order the lessee to pay royalties based on the \$4/mcf figure.

Likewise, the *Roye Realty* court should have considered whether the take-or-pay proceeds constituted part of the price paid for gas under the contract. In doing so, the court should have noted the circumstances surrounding the origins of take-or-pay clauses. In particular, the ceiling prices established by the FPC in the interstate gas market made price competition impossible for the pipelines. Lucrative take-or-pay provisions in the 1970s developed as a way for pipelines to compete with each other.¹⁰⁰

It stands to reason that were it not for the price regulations, lessors would have received royalties on higher contract prices. Instead, lessees have been the sole beneficiary of the take-or-pay proceeds. At the very least, a discussion of *Tara* is necessary to explain why such proceeds are not part of the contract price. Given these obvious similarities between the issues presented in *Tara* and those in *Roye Realty*, it is highly questionable as to why the Oklahoma Supreme Court failed to mention *Tara* in the *Roye* opinion.

B. *Roye's Reliance on Inapplicable Cases*

1. *Walden v. Potts*

Perhaps even more alarming than the court's omission of *Tara* is the court's reliance on two, arguably inapplicable, cases for its definition of the terms "produced" and "sold" in Oklahoma. Relying on *Walden v. Potts*,¹⁰¹ the court stated that the word "produced" requires extraction from the ground.¹⁰²

cases with regard to other forms of consideration lessee's receive in today's natural gas market, including inventory charges allowed by the Federal Energy Regulatory Commission. See 3A W.L. SUMMERS, THE LAW OF OIL & GAS § 589A, at 43 (West Supp. 1996).

99. "Mcf" is one thousand cubic feet.

100. See Gregory M. Travaglio, *Measuring Seller's Damages for Breach of Long-Term Gas Purchase Contracts*, 14 E. MIN. L. FOUND. § 23.03 n.119 (1993) (citing 4 W.L. SUMMERS, LAW OF OIL & GAS § 762).

101. 152 P.2d 923 (Okla. 1944).

102. See *Roye Realty & Developing, Inc. v. Watson*, No. 76848, 1996 WL 515794, at *9 (Okla.

Walden involved a dispute as to whether oil was produced in paying quantities¹⁰³ or whether the lease terminated according to its terms. The lessor had instituted the suit to cancel the oil and gas lease, alleging the lessee had ceased production completely for periods of more than ten days, and had never produced oil in paying quantities during the term of the lease.¹⁰⁴ Evidence at trial showed that the oil produced was of extremely low quality and could not cover operating costs.¹⁰⁵ The trial court found that "no oil and gas was ever discovered or produced in paying quantities from said premises and no well was ever completed to warrant the extension or continuance of said lease."¹⁰⁶ The *Walden* court affirmed, holding that production in paying quantities means that oil must be produced in quantities that will pay a profit to the lessee over operating expenses.¹⁰⁷ Accordingly, the court agreed that the well never produced oil or gas in paying quantities.¹⁰⁸

It must be assumed that the *Roye Realty* court relied on the *Walden* trial court's quotation above for support of its proposition that "production" requires extraction, as no other language in the *Walden* opinion comes close to the definition given by the court. Needless to say, the language in *Walden* hardly supports the bold proposition made by *Roye Realty*. To the contrary, it is firmly established in Oklahoma that the term "production" as used in the habendum clause only requires the capability of production, not actual production, to extend a lease into its secondary term.¹⁰⁹ The Oklahoma position differs substantially from states following the majority rule, such as Texas, which hold that a well must be producing in paying quantities at the end of the primary term to extend the lease into the secondary term.¹¹⁰ Oklahoma, however, merely requires discovery and the capability of production, coupled with diligent efforts to market the gas to preserve the lease.¹¹¹ Moreover, it is a fundamental principle in construing oil and gas leases that the court should consider all provisions in the lease and use each provision to help interpret others.¹¹² Accordingly, the term "production" should be given the same meaning in the gas royalty clause as it is in the habendum clause

Sept. 10, 1996).

103. A well must not only be producing oil or gas but must also be producing in such quantities as will enable the operator to recover a profit if the lease is to survive. *See Walden*, 152 P.2d at 924. This requirement has been the subject of much litigation, as it requires a determination of what expenses and revenues should be included in the calculation.

104. *See id.*

105. *See id.*

106. *Id.*

107. *See id.*

108. *See id.* at 924-25.

109. *See, e.g., State ex rel. Comm'r of Land Office v. Amoco Prod. Co.*, 645 P.2d 468, 470 (Okla. 1982) ("It is the ability of the lease to produce that is the important factor rather than actual production . . ."); *Gard v. Kaiser*, 582 P.2d 1311 (Okla. 1978); *McEvoy v. First Nat'l Bank & Trust Co.*, 624 P.2d 559 (Okla. Ct. App. 1980).

110. *Monsanto Co. v. Tyrrell*, 537 S.W.2d 135 (Tex. Civ. App.—Houston [14th Dist.] 1976, writ ref'd n.r.e.).

111. *See supra* notes 92, 109.

112. *See Panhandle Coop. Royalty Co. v. Cunningham*, 495 P.2d 108, 113 (Okla. 1971).

of a lease. In other words, only the capability of production, not actual production, is necessary to incur an obligation to pay royalties.

The *Roye Realty* Court clearly erred in relying on *Walden* for the definition of production in Oklahoma. Instead, the court should have found that gas was "produced" for the purpose of the gas royalty clause when the well was capable of producing and the lessee had the gas by entering into a gas purchase contract.

2. *Wood v. TXO Production*

Equally questionable is the *Roye Realty* court's reliance on *Wood v. TXO Production Corp.*¹¹³ for the assertion that a sale only occurs once gas enters the pipeline. In *Wood*, the Oklahoma Supreme Court answered a certified question for the United States District Court for the Eastern District of Oklahoma which asked: "Is an oil and gas lessee/operator who is obligated to pay the lessor '3/16 at the market price at the well for the gas sold,' entitled to deduct the cost of gas compression from the lessor's royalty interest?"¹¹⁴ The court answered in the negative.¹¹⁵

A royalty owner is entitled to a share of production without bearing the costs of production.¹¹⁶ However, the physical extraction of gas from the ground is merely one step in what may be a series of activities necessary for gas to be "produced" and delivered to the pipeline. The gas may undergo several processing stages to improve its quality and increase its selling price before it is delivered. Naturally, courts are frequently called upon to determine which costs may be assessed to royalty owners and which costs must be borne exclusively by the lessee/operator as costs of production. The question before the *Wood* court was such an issue.

In determining that compression costs could not be passed on to the royalty owners, the court held that when the gas is sold on the premises, as it was in *Wood*, there are no transportation costs assessed against the royalty owner.¹¹⁷ Finding that compression costs are derived from the process of delivering the gas to the pipeline, the court concluded that the lessee incurred the costs while fulfilling his obligation to make the gas marketable.¹¹⁸ As such, they could not be assessed against the lessor's royalty interest.¹¹⁹

The cost issue presented in *Wood* was of an entirely different nature than the royalty issue in *Roye Realty* and should not have been relied on by the court in coming to its decision. A lessee has an obligation to develop, produce, and make the gas available for market under the lease, the costs of which are not attributable to the lessor's royalty interest.¹²⁰ The lessee's implied duty to market means the duty to get the product to the place of sale in marketable form.¹²¹

113. 854 P.2d 880 (Okla. 1992).

114. *Id.* at 880.

115. *See id.*

116. *See* 1 EUGENE O. KUNTZ, A TREATISE ON THE LAW OF OIL & GAS § 15.4, at 438 (1987).

117. *See Wood*, 854 P.2d at 881-82.

118. *See id.* at 881.

119. *See id.* at 883.

120. *See id.*

121. *See id.* at 882.

Under *Tara*, a lessee satisfies his duty to market the gas upon entering into a gas purchase contract with the pipeline.¹²² Consequently, the determination of where the gas is "sold" as part of calculating what costs are assessed against the lessor's royalty interest, as was the case in *Wood*, does not resolve the issue of whether a sale has occurred, for the purpose of determining a royalty obligation.¹²³ The *Tara* decision suggests that gas may be considered sold upon execution of the gas purchase contract, given the fact that a lessee satisfies his royalty obligation upon entering into an arm's-length purchase contract with a pipeline. Nor is the holding of *Wood* inconsistent with the principle of allowing a royalty owner a share of take-or-pay proceeds. Courts applying Arkansas law have also held that lessees may not deduct compression costs from royalties,¹²⁴ but allows royalty on take-or-pay settlement proceeds.¹²⁵ The *Roye Realty* court's reliance on *Wood* is clearly erroneous as a basis for denying royalty owners a share in settlement proceeds, and conflicts with jurisdictions that have previously decided identical issues in better-reasoned opinions.

C. Fairness Requires the Inclusion of Take-or-Pay Proceeds in Royalty Payments

Moreover, practical reasons exist for allowing royalty owners to share in the settlement proceeds from take-or-pay litigation. When a producer/lessee settles with the pipeline, he is either allowing for the repudiation of the contract itself or modifying the price term in exchange for a substantial amount of money as damages. While the lessee reaps the entire benefit of this settlement, the lessor receives nothing, and is now forced, under *Tara*, to receive a substantially reduced royalty payment calculated on the new, lower contract price.

This outcome directly conflicts with the reasoning behind *Tara* in binding the lessors to the gas purchase contracts. The *Tara* court, in declining to calculate royalty payments on the higher, current price for gas, noted that the lessees "did not themselves profit in any way from the increases in gas prices."¹²⁶ The court was

122. See *Tara Petroleum Corp. v. Hughey*, 630 P.2d 1269, 1273 (Okla. 1981).

123. Producers may argue that adopting the same definition of production in the royalty clause as is applied to the habendum clause would require lessees to pay royalties anytime they entered into a gas purchase agreement, even before gas is extracted from the ground or payment from the pipeline is received. Once again, however, there is a conceptual difference between the elements constituting the price for gas, which determines the amount of the royalty payment, and the triggering event which requires the payment to be made. For example, if a lessee entered into a gas purchase contract whereby he was to receive \$10 million up front for gas that was to be delivered 6 months later, there would be little doubt that the \$10 million constituted the price for the gas. Yet, the lessee may not be required to tender payment to the royalty owner until delivery of the gas was made. Take-or-pay payments are similar in that they are advance payments made for gas which may be "made up" or delivered at a later date. The settlement of these take-or-pay contracts deprives the lessor an opportunity for the payment triggering event (the delivery) to occur. The settlement proceeds can therefore be viewed as constituting part of the price of gas already taken, entitling the royalty owner to share, or payment for gas that could have been taken *but for* the lessee's breach of its marketing duty to its lessor, thereby entitling the royalty owner to damages.

124. See *Hanna Oil & Gas Co. v. Taylor*, 759 S.W.2d 563, 565 (Ark. 1988).

125. See *Klein v. Jones*, 980 F.2d 521, 531-32 (8th Cir. 1992).

126. *Tara*, 630 P.2d at 1274.

concerned about the intrinsic "fairness" of requiring the lessee to pay royalties on fluctuating gas prices while their revenues remained constant under the gas purchase contract.¹²⁷ However, the court limited its holding, noting that if the lessee did not protect the lessor's interests when executing the contract, he has not discharged his duty to market the gas.¹²⁸

At least one prominent commentator espouses the same view. In Summers' treatise on the Law of Oil and Gas, he writes:

Generally, [in take-or-pay settlements] the lessee is given a cash payment in exchange either for a release or a modification of volume or price obligations imposed upon the purchaser by the gas contract. In either event, the lessee is trading off contract terms that benefit both the lessor and the lessee for benefits that go into the lessee's pockets. The lessee's judgment should be subject to scrutiny under the reasonable prudent operator standard, and there is a strong argument that the benefits of the settlement, buy-down or buy-out should be shared proportionately.¹²⁹

It would be unduly harsh to allow the producers to retain all of the take-or-pay settlement proceeds while forcing lessors to accept new, lower contract prices. In these settlements, lessees realize substantial revenues that should be shared with the lessor. The settlements deny the lessors the right to receive royalties on gas sold at the old contract prices under the *Tara* approach. In executing these settlements, the lessees are not protecting the lessor's interests. The Oklahoma Supreme Court should be as concerned about the intrinsic fairness to the royalty owners as it was about the fairness to the producers in *Tara*. If the lessor's interests are to be adequately protected with regard to take-or-pay settlement proceeds, they should be entitled to share in those proceeds.

V. Conclusion

In rendering its decision in *Roye Realty v. Watson*, the Oklahoma Supreme Court reached a startling decision in a brief and poorly reasoned opinion. By holding that royalty owners are not entitled to share in take-or-pay settlement proceeds, the court deviated from its practice of looking past the specific language in oil and gas leases to determine the intent of the parties. In doing so, the court allowed lessees the means to reap enormous benefits through take-or-pay settlements while denying lessors their fair share.

The court declined to follow the lead of Arkansas and Louisiana courts, which have adopted the cooperative venture theory in regard to take-or-pay payments. The positions espoused by these jurisdictions, while in the minority, were consistent with interpretive principles applied in Oklahoma. Instead, the Oklahoma Supreme Court

127. See *id.* at 1273.

128. See *id.* at 1274.

129. 3A SUMMERS, *supra* note 98, at 42.

chose to apply the reasoning of Texas courts addressing this issue, despite the fact that Oklahoma has consistently rejected Texas definitions of “production” and “market value” in gas leases.

The court's opinion in *Roye Realty* does little to explain the foundation for the court's conclusions, and fails to discuss applicable Oklahoma case law that conflicts with the position announced by the court. Most alarming of all, the court's judgement was based on misstated holdings from inapplicable cases, raising serious precedential concerns for future oil and gas issues. Instead of taking the opportunity to definitely resolve an issue of great importance in Oklahoma, the court simply added to the confusion.

James Muenker