SMU Law Review

Volume 25
Issue 1 *Annual Survey of Texas Law*

Article 6

1971

Oil and Gas

Gene L. McCoy

OIL AND GAS

by

*Gene L. McCoy**

I. ROYALTY APPORTIONMENT

An earlier *Annual Survey*[1] commented at length on the Texas supreme court decision in *Montgomery v. Rittersbacher*,[2] which held that a royalty owner has an election either to ratify or repudiate an unauthorized attempt by the holder of the executive rights to pool the royalties. With marginal trepidation, it was noted that this opinion would be the catalyst for subsequent litigation. The hope that future decisions would amplify the character and effect of the royalty owner's election has been totally frustrated by the decision in *May v. Cities Service Oil Co.*,[3] in which the court was virtually oblivious to *Montgomery*. In order to understand the holdings of this case it is necessary to focus on the earlier decision in *Guaranty National Bank & Trust Co. v. May*,[4] which involved the same parties and properties. In *Guaranty* May, who owned the surface, the full executive rights, and a portion of the royalty, executed an oil and gas lease covering the full mineral interest in a tract of 401.2 acres comprised of five separate but contiguous tracts in which the royalty was owned as follows:

Tract 1	(80.3 acres):	May — 1/8
Tract 2	(40 acres):	May — 1/16; Brookshire — 1/16
Tract 3	(80.3 acres):	May — 1/16; Koch — 1/16
Tract 4	(160.6 acres):	May — 1/16; Brookshire — 1/16
Tract 5	(40 acres):	May — 1/16; Hampton — 1/16

Shortly after the lease was executed, it was ratified by Brookshire and Hampton, but Hampton's ratification specifically provided that his royalty would not be pooled or unitized with that of the other owners. Koch did not expressly ratify or repudiate the lease. The lessee then completed a producing gas well on Tract 3 (Well #1). May, claiming to own 1/16th of the proceeds from Well #1, brought suit for a declaratory judgment that the lease had not been communitized, that Brookshire was estopped to assert that it had been, and that Brookshire did not own any of the royalty from Well #1. The Corpus Christi court of civil appeals held that since less than all of the royalty owners had ratified the lease, as a matter of law, there could be no communitization. Furthermore, the court held that since Brookshire had, for a period of over six years, received royalty on a non-communitized basis from production from a well located on

* A.B., Baylor University; LL.B., Southern Methodist University. Attorney at Law, Dallas, Texas.

[1] McCoy, *Oil and Gas, Annual Survey of Texas Law*, 23 Sw. L.J. 72, 72-75 (1969).

[2] 424 S.W.2d 210 (Tex. 1968).

[3] 444 S.W.2d 822 (Tex. Civ. App.—Beaumont 1969), *error ref. n.r.e.*

[4] 395 S.W.2d 80 (Tex. Civ. App.—Waco 1965), *error ref. n.r.e.* This case has received some criticism. *See* Flittie, *Oil and Gas, Annual Survey of Texas Law*, 21 Sw. L.J. 29, 35 (1967).

adjoining property which was unitized with a portion of Tract 4, Brookshire was estopped to assert a right to share in Well #1 on a communitized basis. Accordingly, the court decreed that the 1/8th royalty from Tract 3 (Well #1) would be divided one half to May and one half to Koch.

During the course of this litigation, gas production from Well #1 declined sharply. During this same period, the lessee drilled a well (Well #2) on Tract 1. Within two months after completion, the monthly gas production from Well #2 was almost ten times the peak production of Well #1. On the day the *Guaranty* proceedings were concluded,[5] Koch recorded an instrument by which he sought to ratify the proration unit of 241.54 acres (Tracts 1, 2, and 3, together with the west 48.6 acres of Tract 4 and an additional five acres from another lease) which included the more prolific Well #2. Prior to the recording of this ratification, the entire royalty from Well #2 had been paid to May. However, after the recording of the instrument, the lessee treated the proration unit as ratified by all of the non-participating royalty owners, thereby substantially reducing May's income from Well #2. May then brought suit, seeking declarations that: (1) Koch's ratification was void, (2) the lessee had not acted in good faith in creating the proration unit for Well #2, and (3) Brookshire was not entitled to any royalty participation in the income from Well #2. Although it is not explicitly stated in the opinion, it appears that Hampton had not then ratified the royalty-pooling aspects of the lease.

The Beaumont court of civil appeals, citing *Montgomery*, held that Koch's posture in *Guaranty* (he was aligned with May in asserting non-communitization) did not estop him from later electing to ratify the lease. The court stated that "[u]ntil Koch ratified, May collected all of the royalty from the production from May #2 [Well #2]. The penalty, if one is to be assessed against Koch for his delay in ratifying the new unit is not to bar him forever from exercising his option, but to deprive him of any benefit therefrom until such time as he takes steps to exercise the option."[6] Therefore, the opinion noted that when "Koch ratified the new pool, he became entitled to his pro rata payments for future but not past production therefrom."[7] The court further held that the decision in *Guaranty* did not estop Brookshire from now participating in the production from Well #2.

The decision in *May* is startling in several respects, not the least of which is non-adherence to the criteria established in *Montgomery* for determining the manner and effect of the non-participating royalty owners' election. Contrary to *Montgomery*, the *May* decision apparently holds that the election to ratify or repudiate is not irrevocable, and may be partial.

Montgomery also held that filing suit to recover royalty on a pooled basis constituted a ratification of the lease, with the result that the royalty

[5] The proceedings in *Guaranty* were concluded on May 25, 1966, when the supreme court denied an application for writ of error with the notation "no reversible error."
[6] 444 S.W.2d at 827.
[7] *Id.*

owner "is as much bound thereby as if he had joined in the original execution thereof."[8] Perhaps the converse is not true, and a repudiation of the lease does not immutably fix the royalty owner's position with respect to subsequent wells. It is certainly arguable that this is the holding in the *May* case. On the other hand, the opinion may mean that the acceptance of royalties on a non-communitized basis, as was true with both Koch and Brookshire, is simply not an election to repudiate the pooling aspects of the lease. This, too, is incompatible with the statement in *Montgomery* that the acceptance of royalties constitutes an election. Moreover, in view of the holding in *Guaranty* that Brookshire's acceptance of royalty on a non-communitized basis barred him from participating in royalty on a pooled basis with respect to Well #1, it is difficult to conceive why those same principles would not apply equally to future production from all other tracts in the lease. The failure of the *May* court to consider these problems is attributable, in large part, to a misplaced emphasis on estoppel rather than an analysis of the repudiation feature of the election. The end result is somewhat quixotic in that the royalties on production from each of three wells, allocable to the same base lease, are owned differently.

Furthermore, patently contrary to *Montgomery, May* holds that the election to ratify or repudiate may be fragmentary, *i.e.*, it need not extend to the entire leased acreage. Koch, taking a very pragmatic approach, specifically limited his ratification to production from the proration unit of 241.54 acres. By this act, he quite obviously attempted to reserve the right to review the relative production of wells subsequently drilled on the lease in order to determine the most economically advantageous option for each future well. Nothing in this decision would preclude Koch or any other non-participating royalty owner from making separate elections for each well. As a result, in the absence of a binding written election unequivocally ratifying or repudiating the lease, the ownership of royalties under lease arrangements of this type cannot be considered settled.

Finally, it appears that the court of civil appeals in *May* ignored the holding in *Guaranty* which requires *unanimous* approval by the royalty owners in order to effect a communitized lease.[9] In *May* one of the royalty owners, Hampton, had still not ratified the lease. Nonetheless, with complete reticence on the issue of unanimous ratification, the court found that the royalties under Tract 1 were communitized.

In another royalty-sharing case, *Coleman v. Railroad Commission*,[10] the supreme court held that a royalty owner is not one of the "owners" defined in the Mineral Interest Pooling Act[11] who is entitled to invoke the jurisdiction of the Railroad Commission to effect compulsory pooling under the Act. Coleman had leased his undivided one-half mineral interest in a 240-acre tract, and later conveyed the surface and his mineral interest

[8] 424 S.W.2d at 215.
[9] This holding was criticized by Judge Goldberg in Howell v. Union Producing Co., 392 F.2d 95, 112 (5th Cir. 1968).
[10] 14 Tex. Sup. Ct. J. 48 (1970).
[11] TEX. REV. CIV. STAT. ANN. art. 6008c (1962).

in a 180-acre portion of the tract to the Veterans Land Board. The Board conveyed the 180 acres to Ashford. The lessee then drilled a producing oil well on that portion of the leased tract which was retained by Coleman. The lessee obtained from the Railroad Commission an order forming an 80-acre proration unit composed of 35 acres owned by Coleman and 45 acres owned by Ashford. Because of the doctrine of non-apportionment,[12] Ashford received none of the royalties attributable to production from the well. Therefore, Ashford petitioned the Railroad Commission under the terms of the Mineral Interest Pooling Act to enter an order pooling his royalty acreage in the proration unit with that of Coleman. The Commission granted the request, issued an order approving Ashford's pooling offer to Coleman, and decreed that the royalty derived from the 80-acre unit should be allocated between Coleman and Ashford according to the ratio of surface acreage owned by each in the total proration unit. In a suit commenced by Coleman to set aside the action of the Railroad Commission, the trial court denied the requested relief, the court of civil appeals reversed,[13] and the supreme court held that the Commission's pooling order was void.

In its exegesis of the statute, the supreme court pointed out that, grammatically, the phrase "any such owner"[14] plainly refers to "owners who have drilled or propose to drill a well on the proration unit to the common reservoir . . . ."[15] Moreover, the court emphasized that, under the Act, one applying to the Commission for compulsory pooling must "set forth in detail the nature of voluntary pooling offers made to the owners of the other interests in the proposed unit . . . ."[16] On this basis, the court cogently stated that a royalty owner under an undrilled tract is so impoverished of legal rights that he has nothing to offer, either in theory or in fact. Based upon this interpretation of the Act, the supreme court held that the compulsory pooling order was void.

While the result reached by the court of civil appeals was plainly motivated by antipathy to the doctrine of non-apportionment as enunciated in *Japhet v. McRae*,[17] the supreme court refused to accept the contention that it was the intent of the legislature to abolish that doctrine, contending that the intent was to ameliorate the "small tract" problem reflected in the *Normanna*[18] decision. Finally, the court shifted the problem back

[12] Japhet v. McRae, 276 S.W. 669 (Tex. Comm'n App. 1925), *holding approved*.

[13] Coleman v. Railroad Comm'n, 445 S.W.2d 790 (Tex. Civ. App.—Texarkana 1969).

[14] TEX. REV. CIV. STAT. ANN. art. 6008c, § 2a (1962), provides:

> When two or more separately-owned tracts of land are embraced within a common reservoir of oil or gas for which the Railroad Commission . . . has established the size and shape of proration units . . . and where there are separately-owned interests in oil or gas embraced within an existing or proposed proration unit in the common reservoir, and the owners have not agreed to pool their interests, and where one or more of the owners have drilled or propose to drill a well on the proration unit to the common reservoir, the Commission, to avoid the drilling of unnecessary wells, or to protect correlative rights, or to prevent waste, shall, on the application to the Commission of *any such owner*, establish a unit and pool all of the interests therein within . . . such proration unit. (Emphasis added.)

[15] 14 Tex. Sup. Ct. J. at 50.

[16] *Id.*

[17] 276 S.W. 669 (Tex. Comm'n App. 1925), *holding approved*.

[18] Atlantic Ref. Co. v. Railroad Comm'n, 162 Tex. 274, 346 S.W.2d 801 (1961).

to the legislature, stating that "[i]f we be mistaken in our conclusion, the legislature will meet in regular session in January, 1971, and can provide by legislation, without equivocation, for invocation of the provisions of 6008c by owners of other interests in the oil or gas in proration units in a common reservoir."[19] It seems doubtful that the legislature will be particularly amenable to this suggestion.

II. Surface Rights

Most of our courts now seem to have accepted firmly the proposition that, in the absence of some specific agreement, a surface owner who seeks to recover from the lessee for damages to the surface has the burden to prove either specific acts of negligence or that the lessee's use of the surface was unreasonable because it was not commensurate with his necessary needs under the circumstances. Although the application of this rule is oftentimes difficult, recent cases manifest an equally onerous burden in assessing damages for the violation of one of these duties. An example of this difficulty is *Reading & Bates Offshore Drilling Co. v. Jergenson.*[20] The surface owners, who operated a cattle-feeding business on a 16-acre tract, sued the oil and gas lessee for drilling an oil well that was located within 200 feet of their barn and in the edge of their ensilage pit. These owners sought to show that their ensilage pit was located at the only suitable place on the tract and that the well destroyed the pit, thereby resulting in the destruction of their cattle-feeding business and permanent damage to their land. The jury found for the landowners on all issues, and specifically found that by drilling the well in this location the operator made an unreasonable use of the land. Judgment was entered for the landowners for damages in the amount of $8,000, based upon the difference between the reasonable market value of the land immediately prior to the drilling of the well ($32,000) and its value immediately thereafter ($24,000). On appeal, the lessee complained that the damages were improperly measured because there was no evidence of damage to the land and the evidence showed that there was only special damage to the ensilage pit. The court, relying on *General Crude Oil Co. v. Aiken,*[21] held that the damages were correctly computed and affirmed the judgment of the trial court.

Under similar facts, the Austin court of civil appeals in *Scurlock Oil Co. v. Harrell*[22] reversed the judgment of the trial court, which had awarded damages based upon the decrease in market value of land over which the defendant operated its oil pipeline. The trial court found that the defendant was negligent in permitting oil to leak from its pipeline onto two tracts of land owned by the plaintiffs. However, the court of civil appeals concluded that testimony that the market value of the land had been diminished by $20 per acre would not support a judgment equal to that

[19] 14 Tex. Sup. Ct. J. at 51.
[20] 453 S.W.2d 853 (Tex. Civ. App.—Eastland 1970).
[21] 162 Tex. 104, 344 S.W.2d 668 (1961).
[22] 443 S.W.2d 334 (Tex. Civ. App.—Austin 1969), *error ref. n.r.e.*

amount multiplied by the number of acres in the tracts, because the evidence did not show that every acre was in fact damaged. The testimony did show that oil existed on and near the surface in numerous places, and that this had a deleterious effect on the ranching operations of the plaintiffs. It would seem that evidence tending to show the presence of oil at several specific locations over a fairly representative area of the entire tract would constitute sufficient evidence to support a finding that oil had damaged the entire tract and that it would not be necessary to prove the existence of oil on each square foot of the entire tract. Interestingly, Justice Hughes dissented and cited *General Crude Oil Co. v. Aiken*, which was not mentioned by the majority.

The doctrine of dominance of the mineral estate over the surface estate has been reaffirmed by the supreme court in *Chambers-Liberty Counties Navigation District v. Banta.*[23] There, the condemnor condemned the surface of a tract of land with the condemnee excepting and reserving "all of the oil, gas and other minerals in and under and that may be produced from said land, together with right of ingress and egress in, over and upon said land for the purpose of or incidental to the exploration, development, production and transportation of such oil, gas and other minerals."[24] In the condemnation proceedings, the landowner sought unsuccessfully to recover damages to the mineral estate. The supreme court upheld the judgment of the trial court, stating that, as a matter of law, there could be no damages to the mineral estate since it remained the dominant estate. The court, in elaborating on this holding, commented that the owners of the mineral estate possessed the common law right to the reasonable use of the surface, and that the "ingress and egress" reservation in the conveyance was merely an expression of the right of reasonable use and not in derogation of it. Conceptually, the court's reasoning is impeccable. However, the many surface-damage cases indicate rather clearly that the exercise of this right may be fraught with substantial difficulty.

In another case involving surface rights,[25] the court of civil appeals construed a 1928 pipeline easement which provided in part: "Said right-of-way being sufficient width to permit the grantee to lay, maintain, operate and remove parallel pipe lines for the transportation of oil or gas . . . ."[26] The easement contained no express provision for the laying of additional pipelines in the future. Following the grant of this easement, the grantee laid an eight-inch gas transmission line across the land. No other pipes were laid until 1968, when Pioneer Natural Gas, the assignee of the original grantee, laid a ten-inch gas transmission line parallel to and approximately ten feet south of the eight-inch line. The surface owner, asserting that the construction of the second pipeline was unauthorized, filed a trespass-to-try-title suit. The landowner was successful and was awarded title to

[23] 453 S.W.2d 134 (Tex. 1970).

[24] *Id.* at 135-36.

[25] Pioneer Nat'l Gas Co. v. Russell, 453 S.W.2d 882 (Tex. Civ. App.—Amarillo 1970), *error ref. n.r.e.*

[26] *Id.* at 883.

and possession of the land and the pipeline. On appeal, Pioneer Natural Gas Company, relying upon the use in the easement of the terms "parallel pipe lines," "pipe line or lines," and "said pipe lines," contended that the grant did in fact authorize it to lay an additional pipeline. The court of civil appeals, in holding for the landowner, stated that since the grant was in general terms when the eight-inch pipeline was laid in 1928, "the grant became fixed and certain and cannot now be enlarged."[27] The court distinguished cases which expressly authorize the laying of additional future pipelines and construed the language in the easement as being inadequate for that purpose. On a collateral issue, the court held that the landowner was not estopped to deny Pioneer's right to lay the additional pipeline merely because he had made no objection to the installation of the pipeline during the course of its construction.

III. Regulatory Cases

American Trading & Production Corp. v. Phillips Petroleum Co.[28] illustrates the draconian penalties imposed upon an operator who completes a producing gas well pursuant to a permit issued by the Railroad Commission which is ultimately declared invalid by the courts. In this case, the defendant sought, under rule 37,[29] a permit for a well on 160 acres as an exception to the field rules requiring 640-acre spacing. When the Commission denied the request, the defendant filed suit and obtained from the trial court a mandatory injunction ordering the Commission to issue the permit. The Commission appealed this decision, and the court of civil appeals ultimately decided that the permit was improperly issued.[30] Immediately after the trial court had issued the injunction, the Railroad Commission issued a permit and the defendant commenced the drilling, which it completed as a producing well. The cost of drilling and completing the well was approximately $300,000, and the well produced approximately $94,000 from the date of its completion until the time of trial. In the present suit, Phillips Petroleum Company, the purchaser of the products from the lease, acting as a stakeholder, tendered into court all of the proceeds of production. The owners of four adjoining producing wells in the same field who were made parties sought to recover the entire sum of $94,000. The action of the trial court in awarding all of the funds to the owners of the adjoining wells was affirmed on appeal, the court holding that: (1) an operator who drills a well under a permit ultimately determinded to be invalid has drilled an illegal well; (2) the violation of a Railroad Commission order creates a private cause of action, which in this case was possessed by adjoining owners of the gas rights in the same field; (3) the adjoining owners' measure of damages is the amount that their legal wells would have produced had it not been for the production

[27] *Id.* at 885.
[28] 449 S.W.2d 794 (Tex. Civ. App.—El Paso 1969), *error ref. n.r.e.*
[29] Tex. R.R. Comm'n R. 37.
[30] Railroad Comm'n v. American Trading & Prod. Corp., 323 S.W.2d 474 (Tex. Civ. App.—Austin 1959), *error ref. n.r.e.*

from the illegal well, which in this case was found to be the entire production; and (4) an operator who drills an illegal well on its own land is not entitled to any of the fruits of its illegal production and may not recoup out of such production the cost of drilling the illegal well.

In *Biskamp v. General Crude Oil Co.*[31] certain royalty owners sought to recover damages from the oil company for violation of "express and implied covenants of the lease agreement."[32] The cause of action of the royalty owners was predicated on the theory that the operator was required to take gas and distillate from all wells in the reservoir in the same relative percentage that the open-flow potential of each of these wells was to the market demand. Of course, the open-flow potential of the well in which these royalty owners had an interest was substantially greater than that of the other wells. The operator had produced from all of the wells equally, but none of the wells produced at its open-flow potential because of a lesser market demand. The trial court concluded that the Railroad Commission had exclusive original jurisdiction and dismissed the suit. Quite correctly, the court of civil appeals reversed this judgment and remanded the case for trial on the merits, holding that since the asserted cause of action was based upon a construction of the lease contract and not upon the violation of any order of the Railroad Commission, the Railroad Commission did not have primary jurisdiction of the controversy.

IV. Interpretation

The Tyler court of civil appeals, in a well-reasoned opinion,[33] concluded that a grant of "oil, gas and other minerals" did not include iron or iron ore.[34] This opinion reviews the plethora of Texas decisions which have construed the meaning of the term "minerals" in various deeds and leases, and concludes that the term has no fixed general definition and must be construed in the light of the particular transaction, with reference to "the instrument and its context."[35] Perhaps the principal impediment to this court's interpretation is the rule that the doctrine of *ejusdem generis*[36] does not apply to mineral grants. The court hurdled this putative problem by reasoning that either this rule had heretofore only been stated as dictum, or else it was no longer viable. The court then concluded that iron ore was not included as a mineral in the grant because: (1) the intention of the parties was to include oil, gas and like minerals and not to

---

[31] 452 S.W.2d 515 (Tex. Civ. App.—San Antonio 1970), *error ref.*

[32] *Id.* at 516. The opinion does not discuss or quote the language of these express covenants.

[33] Guinn v. Acker, 451 S.W.2d 549 (Tex. Civ. App.—Tyler 1970), *error granted.*

[34] The deed in question covered land located in Cherokee County, Texas, where iron ore is found extensively. In many places the ore rock lies on top of the ground, and in others it lies only a few feet below the surface. The ore is mined by the "strip-mine" or "pit-mine" methods, by which the overburden of the surface soil is removed with bulldozers and the ore is then dug out with power equipment.

[35] 451 S.W.2d at 551.

[36] The phrase *ejusdem generis* means "of the same kind or species." The court stated it "is a rule of construction to aid in ascertaining the meaning of a statute or written instrument, the doctrine being that where an enumeration of specific things is followed by some more general word or phrase, such general word or phrase is to be held to refer to things of the same kind, but it is only a rule of construction, and never overrules an intention that is clear." *Id.* at 552.

include iron ore; (2) the words "oil, gas and other minerals" should be given their ordinary and natural meaning; (3) iron ore is not a rare mineral, at least not in Cherokee County, nor does it possess a peculiar characteristic giving it special value or classification different from the general soil in the same area; (4) iron ore, which is usually found on the surface and at shallow depth, is so closely related to the soil that it ought to be considered an integral part of the surface estate rather than the mineral estate; and (5) the mining methods used to remove the ore practically annihilate the use and value of the surface estate. The Supreme Court of Texas has granted writ of error. Hopefully, it will recognize that the issues and problems raised in this case transcend the narrow issue of iron ore and will, in deciding the merits of the case, expand upon the reasoning used so that some reasonable criteria will be established by which such mineral grants may be interpreted.

The right of an operator to charge administrative overhead expenses in the amount of $800 per month under a net-profits operating agreement was examined in *Western Oil Fields, Inc. v. Pennzoil United, Inc.*[37] The agreement in question authorized the operator, Pennzoil, to charge lifting and operating costs at a rate of $3,200 per month. Furthermore, article 3 of the agreement defined net profits as the excess of gross revenues over all costs and expenses. However, language in a "boiler plate annex" to the agreement, entitled "Administrative Overhead," provided for charging specific overhead costs, which were stated to be "in lieu of any charge for any part of the compensation or salaries of managing officers."[38] Pennzoil admittedly withheld the administrative charges from 1961 to the date of trial. In this suit, Western sought to recover its proportionate part of those charges. The court correctly distinguished *Luling Oil & Gas Co. v. Humble Oil & Refining Co.*,[39] and held that the "boiler plate annex" explicitly barred all charges in the nature of administrative overhead.

V. TAX CASES

In a case[40] involving the Gas Production Tax,[41] the supreme court held that the taxable "market value" of gas produced and processed pursuant to an agreement between a lessee and royalty owners is measured, as to all ownership interests, by the proceeds of the sale of gas after processing, less transportation and processing costs. Although the lessee, Mobil Oil Co., paid its royalty owners 1/8th of the sale price of the gas and products after processing, thereby absorbing the entire cost of processing, the state may not tax the two separate interests by collecting the tax on the full 1/8th of sale proceeds allocated to the royalty owners and on the lessee's 7/8ths of the proceeds after deduction of only 7/8ths of the cost. Rather, "market value" is determined by subtracting all costs from the final sale

[37] 421 F.2d 387 (5th Cir. 1970).
[38] *Id.* at 388.
[39] 144 Tex. 475, 191 S.W.2d 716 (1945).
[40] Mobil Oil Co. v. Calvert, 451 S.W.2d 889 (Tex. 1970).
[41] TEX. TAX-GEN. ANN. art. 3.01 (1969).

price, and each taxable ownership interest is then liable to the state for its proportionate part of the tax. Moreover, the taxable "market value" of gas returned by the processor to the producer for use in its operations on the lease is the price the producer would have received from the sale of the gas, rather than the price which the processor might have ultimately received had it sold the gas.

In another tax case,[42] involving the Texas Sales and Use Tax,[43] it was held that a scouting firm which offered its subscribers regular reports regarding the drilling and production of various oil and gas wells was not liable for the sales tax on the monthly charges it received for this information. To the chagrin of the comptroller, the court concluded that the monthly charge was made for services, namely, technical data acquired through personal observation by the taxpayer's personnel in the field, and not for the sale of tangible personal property.

The tax benefits usually derived from the *ABC* transaction—always an anathema to the Internal Revenue Service—have been virtually emasculated by the 1969 Tax Reform Act.[44] The hostility of the IRS to these transactions is exemplified in a recent case involving Texas property but not Texas substantive law.[45] The facts were that *A* sold producing oil and gas properties to *B* for a cash consideration of $475,000 and reserved a production payment in the amount of $500,000 payable out of eighty-five per cent of the net working interest, which *A* promptly transferred to *C*. Although *B* intended to operate the property at a profit, the income from the property was less and the expenses were more than anticipated, so that the proceeds received by *B* from his fifteen per cent operating interest were insufficient to operate the properties at a profit. Accordingly, the Commissioner contended that the excess of expense over income accruing to the working interest was foreseeable and should be capitalized as an acquisition cost of the properties. Although the tax court rejected the Commissioner's theory,[46] it promulgated a rule much more inimical to the taxpayer and to those who rely on the tax savings of the *ABC* transaction. The tax court held that, without regard to whether the operator had a profit or loss from property subject to a reserved production payment, all of the operating expenses allocable to the eighty-five per cent production payment should be capitalized. The Fifth Circuit unequivocally rejected both the Commissioner's position and the holding of the tax court, and found that the expenses were fully deductible. In reaching this conclusion, the court aptly noted "[w]e must not let possible disdain for the ABC transaction nibble away its sanction by impermissible theories of capitalization of expenses attributable to oil and gas production."[47]

[42] Williams & Lee Scouting Serv., Inc. v. Calvert, 452 S.W.2d 789 (Tex. Civ. App.—Austin 1970), *error ref.*

[43] TEX. TAX-GEN. ANN. art. 20.01 (1969).

[44] INT. REV. CODE of 1954, § 636.

[45] Brooks v. Commissioner, 424 F.2d 116 (5th Cir. 1970).

[46] Brooks v. Commissioner, 50 T.C. 927 (1968).

[47] 424 F.2d at 123.

VI. MISCELLANEOUS OPERATIONAL CASES

Padre Drilling Company commenced the drilling of an oil well for Tenneco Oil Company under a written contract. In drilling the well, Padre was subjected to numerous vicissitudes, one of which was "heaving shell." As a result, Padre abandoned this well and moved its rig to a new location. Controversy then arose between Tenneco and Padre as to Tenneco's liability for the cost of drilling the well. Padre sued and was awarded judgment in the trial court for $71,000 plus $20,000 attorneys' fees. The supreme court upheld the award of damages, but, because the contract made no provision for attorneys' fees and since such an award was not sanctioned by any statute, it denied Padre the right to recover attorneys' fees.[48] In reaching this conclusion, the court held that the claim was not authorized under article 2226, which permits recovery of attorneys' fees by "[a]ny person having a valid claim against a person or corporation for personal services rendered, labor done, material furnished, . . . or suits founded upon a sworn account or accounts . . . ."[49] Predicated upon its prior holdings, the court found that this was not a suit on a sworn account since there was no sale by which the title to personal property passed from one to another. Moreover, the court held that "a corporation cannot have a claim for 'personal services rendered' or for 'labor done' within the meaning of Article 2226,"[50] nor could there be any recovery for material furnished, since this was a service contract.

In *Sadler v. Akin*[51] the Commissioner of the General Land Office issued an order canceling four mineral prospecting permits and forfeiting a lease pursuant to article 5421c-7.[52] The plaintiff then instituted suit against the Commissioner, seeking a declaration that the forfeited permits and lease were valid. The trial court overruled the Commissioner's plea in abatement that the suit was against the state without prior legislative permission having been obtained, and granted summary judgment for the plaintiff. This action was reversed by the court of civil appeals, which declared that the action was in fact a suit against the state of Texas.

The plaintiff in *Chandler v. Herndon*[53] purchased an undivided 1/8th interest in an oil and gas lease for $1,500. The defendant, in consideration of the purchase price, agreed to undertake the reworking of a well on the lease in an attempt to re-establish commercial production of gas. The attempt failed and the lease was lost. The plaintiff then filed this suit on the theory of a joint venture, seeking to recover his proportionate share of unexpended funds. Although there remained in the operator's possession funds in excess of the actual reworking costs, the court of civil appeals nevertheless found that, in view of the turn-key price, no joint venture existed because there was no mutual right of control, no community of interest, and no agreement to share the cost of the reworking operation.

---

[48] Tenneco Oil Co. v. Padre Drilling Co., 453 S.W.2d 814 (Tex. 1970).
[49] TEX. REV. CIV. STAT. ANN. art. 2226 (1964).
[50] 453 S.W.2d at 820.
[51] 452 S.W.2d 938 (Tex. Civ. App.—Austin 1970), *error ref. n.r.e.*
[52] TEX. REV. CIV. STAT. ANN. art. 5421c-7 (1962).
[53] 450 S.W.2d 703 (Tex. Civ. App.—Corpus Christi 1970), *error ref. n.r.e.*