
January 1973

Oil and Gas

Bob F. Young

Recommended Citation

Bob F. Young, *Oil and Gas*, 27 Sw L.J. 56 (1973)
<https://scholar.smu.edu/smulr/vol27/iss1/6>

This Article is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in SMU Law Review by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

OIL AND GAS

by

Bob F. Young*

SINCE the last *Survey* Texas courts have decided two cases which are of major significance to the oil and gas industry due to their economic impact and the legal principles involved.¹ Each of these cases will be reviewed under the appropriate topic.² While these cases deserve special attention, decisions concerning pooling and unitization, disposition of the proceeds from production, taxation, and procedure will also be discussed.

I. SURFACE USE

*Sun Oil Co. v. Whitaker*³ was reviewed in last year's *Survey*.⁴ Since that time, the Supreme Court of Texas has withdrawn its opinion, and, in a five-to-four decision, reversed the holding of the court of civil appeals.⁵ It is one of those rare decisions in which the supreme court found no evidence to support the jury's findings of fact. But the decision is not based solely on the evidence question, and an important legal relationship between a surface owner and his mineral lessee was established.

A brief statement of the facts will be sufficient. The plaintiff, Whitaker, was the owner of the surface estate, the minerals having been reserved to his grantor. Sun Oil Company's oil and gas lease predated Whitaker's purchase and provided: "Lessee shall have free use of . . . water from said land except water from Lessor's wells for all operations . . ."⁶ Sun undertook a secondary recovery operation by waterflood, which required the use of 4,200,000 barrels of Ogallala Formation fresh water from a well located on Whitaker's land. It was estimated that the waterflood would provide an additional recovery from the reservoir of \$3,200,000 worth of oil. It was also estimated that the use of 4,200,000 barrels of fresh water in the waterflood would shorten the life of Whitaker's water supply by eight years.

The Ogallala Formation is a vast, but depleting, underground water reservoir. The agricultural economy of the area has flourished from the use of this water for irrigation, and Whitaker relied on fresh water wells to irrigate his land. The formation is like a bowl extending from eastern New Mexico across the high plains of Texas.⁷ It is not like an underground stream which is occasionally tapped, but more like a closed bowl into which many straws are inserted to obtain fresh water. Although Sun could have purchased its water

* B.B.A., University of Georgia; LL.B., University of Texas. Attorney at Law, Dallas, Texas.

¹ *Sun Oil Co. v. Whitaker*, 483 S.W.2d 808 (Tex. 1972); *Gulf Oil Corp. v. Southland Royalty Co.*, 478 S.W.2d 583 (Tex. Civ. App.—El Paso 1972), *error ref. n.r.e.*

² See text accompanying notes 3-14, 19-24 *infra*.

³ 15 Tex. Sup. Ct. J. 60 (1971), *rev'd on rehearing*, 483 S.W.2d 808 (Tex. 1972).

⁴ McCoy, *Oil and Gas, Annual Survey of Texas Law*, 26 Sw. L.J. 59, 61-63 (1972).

⁵ 457 S.W.2d 96 (Tex. Civ. App.—Eastland 1970), *rev'd*, 483 S.W.2d 808 (Tex. 1972).

⁶ 483 S.W.2d at 810.

⁷ Texas Water Comm'n, *The Development of the Science of Hydrology*, Circular No. 63-03 (prepared for presentation at a public hearing held by the Texas Water Pollution Control Board on Sept. 25, 1963, at Austin, Texas).

from the owner of an adjoining tract for \$42,000, the water well on the adjoining tract would merely have represented another straw in the bowl.

The court's reasoning in its final decision is substantially the same as that in the decision which it withdrew, except for the finding of no evidence to support the jury's findings of fact. The court did not rely on the express grant of the right to use water which was contained in the lease, but instead found that Sun had an implied right to free use of so much of the subsurface water as might be reasonably necessary to produce the oil from its wells. The court then held that a waterflood project is a reasonable operation under an oil and gas lease, and that Sun's waterflood was a reasonable operation, since the parties had stipulated that "the use of Ogallala water was reasonably necessary to effectuate the purposes of the lease."⁸ In response to special issues, however, the jury had found that it was not reasonably necessary for Sun to use fresh water from Whitaker's land for the waterflood project. Departing from its prior decision, the court found that there was no evidence to support the jury's finding and, therefore, Whitaker was permanently enjoined from interfering with Sun's use of up to 100,000 gallons of fresh water per day from his land.

The court indicated that the use of fresh water from Whitaker's land was reasonably necessary because efforts to use available salt water had failed and no other water was available on the leased tract. The court stated: "To hold that Sun can be required to purchase water from other sources or owners of other tracts in the area, would be in derogation of the dominant estate."⁹ The court added that its holding in *Getty Oil Co. v. Jones*¹⁰ was not applicable to this situation. In *Getty* the court had required the oil and gas lessee to locate its pumps below the height of the surface owner's irrigation system so that production of the minerals would not interfere with the use of the surface as an irrigated farm. However, in *Whitaker* the court expressly limited its holding in *Getty* "to situations in which there are reasonable alternative methods that may be employed by the lessee on the leased premises to accomplish the purposes of this lease."¹¹

In the dissenting opinion,¹² Justice Daniel maintained that Sun did not have either an express or implied right to deplete the fresh water in its secondary recovery operations. The majority had not found it necessary to consider the effect of the free water clause, since it had found an implied right to use water for the waterflood. However, Justice Daniel found that the terms of the lease and the circumstances existing at the time it was executed established that the parties did not intend the grant of the right to use water to extend to the extensive use of fresh water for secondary recovery operations.¹³ Likewise, the implied right to use water for ordinary drilling and production did not include

⁸ 483 S.W.2d at 811 (emphasis by the court).

⁹ *Id.* at 812.

¹⁰ 470 S.W.2d 618 (Tex. 1971), reviewed in McCoy, *supra* note 4, at 59-61.

¹¹ 483 S.W.2d at 812 (emphasis by the court).

¹² *Id.*

¹³ Justice Daniel cited the following evidence to support his conclusion. (1) the absence of any specific provision in the lease relating to secondary recovery by waterflood; (2) the specific provision for the protection of the lessor's wells and growing crops; and (3) the fact that waterflooding was not practiced in the west Texas area when the lease was signed in 1946. *Id.* at 815.

the right to use the fresh water in secondary recovery operations "in a manner which substantially destroys and diminishes the surface estate."¹⁴ Justice Daniel argued that the majority had re-established the absolute dominance of the mineral estate with its holding that the *Getty* test of reasonable necessity, based on the uses being made by the surface owner and the alternatives available, was not applicable because the only alternative water source was not on the leased premises. Thus, he considered the majority decision to be a departure from the trend toward accommodation of the interests of the mineral lessee and the surface owner.

Two other cases involving conflicts between a landowner and the oil and gas operator over the use of the surface were decided during the year. In *Kennedy v. Brandenburg*¹⁵ the landowner, Brandenburg, brought suit for damages caused by brine water leaking from the defendant's pipeline. Brandenburg alleged that the defendant was negligent in allowing the line to break and in failing to keep a proper lookout for breaks. The trial court refused to submit special issues based on the theory of negligence to the jury. Instead, the trial court submitted issues inquiring only whether the defendant had allowed the brine to enter the plaintiff's irrigation canal and whether that was the proximate cause of any of the damages sustained by the plaintiff. The jury returned a verdict for the plaintiff with money damages. The defendant appealed and argued that the trial court had erred in submitting special issues to the jury based on the theory of strict liability rather than negligence. The court of appeals reversed and remanded the case on the basis of the holdings in *Turner v. Big Lake Oil Co.*¹⁶ and *Humble Pipeline Co. v. Anderson*,¹⁷ which established that strict liability did not apply to the operation of pipelines. Therefore, the court held that in order for the plaintiff to recover, he must allege and prove negligence of the defendant and that this negligence was a proximate cause of his damages.

In the second case¹⁸ the court of civil appeals upheld the granting of a temporary injunction against the landowners in favor of the oil company. Texas Pacific Oil Company was the operator under a unit agreement ratified by the landowners. The landowners claimed that Texas Pacific was not entitled to a temporary injunction because the route which Texas Pacific sought to use as a roadway was not the only road available, and it interfered with the landowners' use of the surface. The appeals court held that the trial court had not abused its discretion in granting the injunction, since the main purpose of a temporary injunction is to maintain the status quo and not to determine the substance of the controversy. The facts of the case did not reveal whether the roadway was already in use; thus, it must be assumed that the status quo which the trial court sought to maintain was the existing use of the roadway by the oil company. Such a case illustrates that the status quo is often an elusive, ill-defined concept.

¹⁴ *Id.* at 812.

¹⁵ 470 S.W.2d 789 (Tex. Civ. App.—El Paso 1971).

¹⁶ 128 Tex. 155, 96 S.W.2d 221 (1936).

¹⁷ 339 S.W.2d 259 (Tex. Civ. App.—Waco 1960), *error ref. n.r.e.*

¹⁸ *Cunningham v. Texas Pac. Oil Co.*, 474 S.W.2d 926 (Tex. Civ. App.—Eastland 1971).

II. CONSTRUCTION OF INSTRUMENTS

In *Gulf Oil Corp. v. Southland Royalty Co.*¹⁹ W. N. Waddell had executed an oil and gas lease to Gulf Oil Corporation on July 14, 1925, for a term not to exceed fifty years. Southland Royalty Company succeeded to a portion of the mineral interest subject to the oil and gas lease. Gulf and others drilled and developed the premises for oil and gas, but the tract would not be depleted by the end of the term of the lease on July 14, 1975. In addition to the habendum clause, however, the lease contained a *force majeure* clause which stated that when "drilling or other operations" are delayed or interrupted by certain enumerated causes, including governmental action, "the time of such delay or interruption shall not be counted against the Lessee—anything in this lease to the contrary notwithstanding."²⁰

Gulf introduced evidence to prove that during the period January 1, 1936, through June 30, 1967, the Railroad Commission of Texas had denied them the right to produce for a period in excess of 4,661 days. As a result of such regulation, the plaintiffs contended that the term of the lease should be extended for an equivalent period of time in order to allow them to recover this production. The trial court withdrew the case from the jury and construed the lease against the plaintiffs. The court of civil appeals affirmed the trial court's judgment.

No contention was made that the instrument was ambiguous, and the court of appeals, therefore, applied the established rule that the intention of the parties must be determined from the instrument alone, taking into consideration the surrounding facts and circumstances as an aid to construction and interpretation. The court cited numerous general authorities for the proposition that the habendum clause in an oil and gas lease is the dominant clause and is not to be extended by other provisions which are indirect, ambiguous, and negative.²¹ In determining whether the *force majeure* clause operated to extend the term of the lease, the court considered other oil and gas leases taken by Gulf at about the same time. It was noted that in each instance an identical *force majeure* clause was included, but that the habendum clause in the other leases provided for a term of years and as long thereafter as necessary to produce; none contained a specific term clause similar to the one contained in this lease. The court considered this to be clear and unmistakable evidence that the parties contemplated a definite and fixed term lease. The court then cited the constitutional amendment of 1917,²² legislation of 1919,²³ and Railroad Commission circulars of 1919 and 1923, all of which concerned the regulation of the oil and gas industry, including regulation of production. The court concluded that the parties contracted with full knowledge of the potential

¹⁹ 478 S.W.2d 583 (Tex. Civ. App.—El Paso 1972), *error granted*.

²⁰ *Id.* at 585-86.

²¹ See, e.g., 2 W. SUMMERS, *THE LAW OF OIL AND GAS* §§ 303.1, 302 (perm. ed. 1938); Walker, *The Nature of the Property Interests Created by an Oil and Gas Lease in Texas*, 8 TEXAS L. REV. 483, 516 (1930).

²² TEX. CONST. art. XVI, § 59(a).

²³ TEX. REV. CIV. STAT. ANN. art. 6014 (1962) (originally enacted as ch. 155, [1919] Tex. Laws 285).

regulation and that the *force majeure* clause was not intended to extend the lease beyond the fifty-year term provided in the habendum clause.

Dissenting,²⁴ Justice Preslar agreed with the basic rules of construction stated by the majority. He contended, however, that the *force majeure* clause was intended by the parties to operate to extend the term of the lease. He relied on the fact that the habendum clause was paragraph 2 under section 1 of the lease; the *force majeure* clause was section 7; and the development clauses, with their own forfeiture terms, were among the six paragraphs of section 1. Thus, he concluded that section 7 was of equal dignity with section 2 because it was to apply "anything in this lease to the contrary notwithstanding." While the majority had held that the term "operations" in the *force majeure* clause referred only to exploration and development, Justice Preslar maintained that the term included production. He found, from the same facts and evidence considered by the majority, that the parties were aware of potential regulation of production and included the *force majeure* clause to cover that eventuality.

*Shuttle Oil Corp. v. Hamon*²⁵ is a case construing a conditional assignment of an oil and gas lease. In 1952 Daube Interests had assigned to Hamon the mineral lease covering a section of land below the depth of 3,000 feet. The granting clause of the assignment was not unusual, but the assignment required the drilling of a well upon one of the quarter sections within 120 days of the date of the assignment. The instrument provided that upon failure to comply with this requirement, the assignment would terminate. Furthermore, if a second well were not commenced within six months after the completion of the first well, the assignment would terminate for all of the sections except the quarter section upon which the first well was drilled. Similar provisions applied to the third and fourth wells and the third and fourth sections.

Hamon drilled a well on the first quarter section in 1952 and completed it as a dry hole. Hamon did not drill any other wells on the section and his lease for the three remaining quarter sections terminated. In January 1970 the Daube Interests assigned whatever interest they had in the section to the plaintiff. One month later, Hamon re-entered the old hole and completed it as a producer.

The plaintiff contended that the assignment to Hamon had terminated by virtue of an implied limitation that the estate be used for the purpose for which the assignment was granted. In the alternative, it claimed that Hamon had abandoned the leasehold because he had done no work on the tract from November 30, 1952, to February 24, 1970. The court held that Hamon had superior title to the leasehold covering the quarter section where he had drilled a well. The court concluded that the terms of the assignment required only that Hamon drill a well to the prescribed depth within the prescribed time in order to earn the leasehold interest conveyed in the assignment. Thus, this decision was based on the simple proposition that Hamon had paid consideration for the assignment of the leasehold on the quarter section in the form

²⁴ 478 S.W.2d at 591.

²⁵ 477 S.W.2d 701 (Tex. Civ. App.—Beaumont 1972), *error ref. n.r.e.*

of the drilling of a well and, therefore, owned the leasehold rights so long as the oil and gas lease out of which the assignment was made remained in force.

The court also rejected the contention that Hamon had abandoned his leasehold interest. The court noted that "[t]here is considerable doubt that a leasehold interest may be lost by abandonment under the present authorities in this state."²⁶ Accepting the possibility of abandonment, however, the court held that the evidence demonstrated that there was no intention to abandon and there had been no actual relinquishment of the enterprise.

*Byrd & Foster Drilling, Inc. v. Centennial Royalty Co.*²⁷ was another relatively simple controversy. The defendants in the trial court, Centennial Royalty Company and M. Ray Hart, each owned an undivided one-half interest in an oil and gas lease. Both of the defendants made an oral agreement with Byrd & Foster to drill a well on the lease. A printed form drilling agreement was completed by Byrd & Foster showing Hart and Centennial as owners of the lease. Centennial executed the agreement but Hart did not. In the letter of transmittal returning the signed agreement to Byrd & Foster, Centennial's agent wrote: "I asked Mr. Ray Hart to have his banker mail you a letter stating that he will (pay) for one-half of the contract drilling of this well as soon as he is furnished with a copy of the log. If it is satisfactory with you, we will be happy to give you a check for payment of our one-half the day the well is logged."²⁸ Thereafter, the well was drilled and Centennial paid one-half of the invoice.

Byrd & Foster filed suit to recover the remaining one-half of the invoice cost alleging joint and several liability under the terms of the drilling agreement. The trial court granted summary judgment in favor of Centennial. On appeal Byrd & Foster claimed that the trial court had erroneously considered the letter of transmittal as evidence, since the parol evidence rule excluded all evidence other than the drilling agreement. The judgment of the trial court was affirmed by the court of civil appeals on the basis of the rule that "where several instruments, executed contemporaneously or at different times, pertain to the same transaction, they will be read together although they do not expressly refer to each other."²⁹

III. POOLING AND UNITIZATION

The "annual case" under the Mineral Interest Pooling Act of 1965³⁰ is *Broussard v. Texaco, Inc.*³¹ Suit was brought by the royalty owners under an oil and gas lease covering the 733.34-acre Broussard tract in Wharton County, Texas, to enjoin the enforcement of a Railroad Commission order force-pooling 26.692 acres out of their tract and 15.342 adjoining acres out of another tract to form a 42.034-acre oil unit. Production was already established from other portions of the 733.34-acre Broussard tract. The trial court denied the plain-

²⁶ *Id.* at 705, citing Walker, *The Nature of the Property Interests Created by an Oil and Gas Lease in Texas*, 7 TEXAS L. REV. 539, 593 (1929).

²⁷ 477 S.W.2d 319 (Tex. Civ. App.—El Paso 1972).

²⁸ *Id.* at 320.

²⁹ *Id.* at 321.

³⁰ TEX. REV. CIV. STAT. ANN. art. 6008c (Supp. 1972).

³¹ 479 S.W.2d 270 (Tex. 1972).

tiffs the relief that they sought. On direct appeal³² the supreme court overruled the trial court and granted the injunction.

The supreme court's interpretation of the Act was that it was not intended to permit the fragmentation of larger tracts by force pooling. The so-called "muscle in" clause³³ was intended only as a means of protecting the small tract owner who had not had a fair chance to pool and would suffer drainage without force pooling. Thus, the clause could not be used to force the combination of unassigned parts of larger tracts which have sufficient acreage for one or more proration units.

In *Yelderman v. McCarthy*³⁴ the defendant, McCarthy, had succeeded to the working interest in a lease of a three-fourths mineral interest in a 225.24-acre tract of land executed by the plaintiff and his wife. On August 21, 1967, McCarthy filed for record a pooling declaration covering 346.82 acres of land which included 117.03 acres out of the Yelderman lease. The pooling declaration did not become effective when recorded because McCarthy did not have the authority to establish a unit embracing less than 640 acres under the terms of a temporary field order issued by the Railroad Commission. The declaration became effective as recorded only on November 21, 1968, when a permanent field order was issued which permitted a minimum gas unit of 320 acres.

The pooling clause of the Yelderman lease, however, provided that "notwithstanding anything contained herein to the contrary, the lessee in pooling said lands shall be limited in authority in creating any unit into a pooled area that will exceed in acreage the minimum size tract on which a well may be drilled, in order to conform to the spacing pattern prescribed in the field by regulatory agencies having jurisdiction thereof for any purpose."³⁵ Since state-wide rule 37 of the Texas Railroad Commission³⁶ established forty acres as the minimum unit size at the time the declaration was executed,³⁷ the attempted 346.82-acre McCarthy-Yelderman gas unit was not authorized by the Yelderman lease.

McCarthy began mailing royalty checks to the Yeldermans on June 6, 1968, and continued through July 27, 1970. Most of these checks bore a notation on the back stating that payment was in full and final settlement for any and all of the royalty owner's interest in the gas and distillate runs for the respective months from the 346.82-acre gas unit as described in the recorded unit

³² TEX. CONST. art. V, § 3-b; TEX. REV. CIV. STAT. ANN. art. 1738a (1962); and TEX. R. CIV. P. 499(a) provide for direct appeals from decisions determining the validity or invalidity of an administrative order of the Texas Railroad Commission.

³³ TEX. REV. CIV. STAT. ANN. art. 6008c, § 2(a) (Supp. 1972), provides:

The Commission shall not require the owner of a mineral interest, the productive acreage of which is equal to or in excess of the standard proration unit for the reservoir, to pool his interest with others, unless requested by the holder of an adjoining mineral interest, the productive acreage of which is smaller than such pattern, who has not been provided a reasonable opportunity to pool voluntarily, in which event the Commission shall pool the smaller tract with adjacent acreage on a fair and reasonable basis and may authorize a larger allowable for such unit if it exceeds the size of the standard proration unit for the reservoir.

³⁴ 474 S.W.2d 781 (Tex. Civ. App.—Houston [1st Dist.] 1971), *error ref. n.r.e.*

³⁵ *Id.* at 782.

³⁶ Rule 37, Tex. R.R. Comm'n Rules & Regs. § 1, at 22.

³⁷ See *Jones v. Killingsworth*, 403 S.W.2d 325 (Tex. 1965).

designation. In most instances the royalty owners cashed the checks with the added notation "accepted as partial payment only as per lease agreement."³⁸ The court held that the acceptance of these checks constituted ratification of the pooled unit under established authority.³⁹ The Yeldermans were only authorized to accept the payment in accordance with its terms, and the conditional acceptance could not alter such terms. Furthermore, the ratification also operated to make the unit designation effective from the date that it was recorded.

IV. PROCEEDS FROM PRODUCTION

During the survey period the courts have considered the proper allocation of the proceeds from production in a variety of situations. In *Miller v. Hathaway*⁴⁰ it was held that a devise of a mineral interest does not include royalty payments accrued prior to the testatrix's death and held by the oil company for her account at the time of her death. The facts of this case were simple. The oil company held an accumulated royalty credit for the account of Mrs. McCaughan in the sum of \$5,654.14 at the time of her death. Mrs. McCaughan's will devised a life estate in the minerals from which these proceeds had accrued to her half-brother, M. E. Miller. Miller brought suit to recover the money held by the oil company, claiming that the testatrix had intended it to be included in the devise of the mineral interest because she had refused to sign the division orders for payment of the royalty during her life. The court found that the cash was part of the testatrix's estate and was not equivalent to the mineral interest devised, since the life estate in the minerals took effect only upon her death. In other words, the devise was of realty and not of unpaid proceeds attributable to such realty before the testatrix's death.

In *Sid Richardson Carbon & Gasoline Co. v. Phillips Petroleum Co.*⁴¹ the court was required to determine the contract price to be paid by Richardson to Phillips for residue gas. The contract provided that the price should be equal to the price which Phillips received for gas sold to El Paso Natural Gas Company from one of Phillips' plants. Pursuant to Federal Power Commission orders, Phillips had made refunds to El Paso with interest. Phillips offered refunds to Richardson on the same basis, but without interest. The court held that interest was due Richardson to place it in parity with El Paso as required by the contract. In addition, Richardson was due interest for the period between the date of the Federal Power Commission order and the date of the judgment.

In another case involving allocation of the proceeds from production,⁴² a federal district court was required to determine whether the grantors in a deed, who had reserved a production payment, had shifted the burden of payment of the occupation tax⁴³ to the grantee. The consideration for execution of the

³⁸ 474 S.W.2d at 783.

³⁹ See, e.g., *Industrial Life Ins. Co. v. Finley*, 382 S.W.2d 100 (Tex. 1964); *Groves v. Sawyer*, 384 S.W.2d 193 (Tex. Civ. App.—Eastland 1964), error ref. n.r.e.

⁴⁰ 477 S.W.2d 655 (Tex. Civ. App.—Austin 1972).

⁴¹ 456 F.2d 203 (5th Cir. 1972).

⁴² *Alexander v. Texaco, Inc.*, 343 F. Supp. 663 (S.D. Tex. 1972).

⁴³ TEX. REV. CIV. STAT. ANN. tit. 122A, arts. 3.01-11, 4.01-14 (1969).

deed was a payment of \$225,000 plus \$575,000 which was to be paid only out of the proceeds from 1/32 of the oil produced from the land. The deed had been executed three years prior to the imposition of the occupation tax,⁴⁴ and the grantee had not been consistent in deducting the tax from the production payment. Thus, the court had to rely entirely on the language of the deed to ascertain whether the parties had intended that the grantee should pay the tax.

The question considered by the court was whether the stated sum of \$575,000 represented the net amount to be received by the grantors, or merely measured the maximum gross amount to be attributed to the reserved 1/32 interest. The court found that the parties had specifically provided for the allocation of certain known liabilities. The 1/32 interest was to be measured by the value of the oil and gas at the well, and, therefore, the grantee would bear production costs. There was to be no interest on the \$575,000 production payment. However, the parties did not make provision in the lease for unforeseen costs and deductions as was the case in the only Texas decision reviewed by the court in which an intent to shift the burden of a tax was found.⁴⁵ Based on this fact, the court held that the plaintiffs had not satisfied their burden of proving that the grantors had intended to shift the tax to the grantee. Therefore, the court concluded that the plaintiffs were entitled only to the value of the 1/32 interest in production reduced by the occupation tax paid on their interest.

In *Bankers Life Insurance Co. v. Scurlock Oil Co.*⁴⁶ Bankers had filed suit against Scurlock for the value of the oil produced from certain leases on which it held a mortgage. Jordan operated three tank batteries in which he collected oil for sale to Scurlock. Two of the batteries, the Kangerga tanks, were not connected to any leases by pipe, but oil was trucked to these tanks from wells on various leases, some of which were mortgaged to Bankers by Jordan. The third tank battery, Still tanks, was connected to wells on the A. L. Still lease which was also mortgaged to Bankers by Jordan. Scurlock purchased oil from Jordan under the terms of two separate division orders, one covering the Still tanks which provided for payment to Bankers, and one covering the Kangerga tanks which provided for payment to Jordan, who was required to make a proper accounting to Bankers. Jordan transferred, by undisclosed and fraudulent means, oil from the Still lease to the Kangerga tanks and sold it to Scurlock. Scurlock then paid Jordan directly. Bankers claimed that Scurlock was required to pay Bankers for all of the oil produced from the Still lease. Scurlock argued that it was only required to pay Bankers for oil actually received under the division order covering the Still tanks. The court held that the language of the division order applicable to the Still tanks did not require Scurlock to pay Bankers for either the oil produced from the Still lease or for the oil produced and delivered to Scurlock from the Still lease, "but only for the oil Scurlock receives from the Still lease under that Division Order." The

⁴⁴ Ch. 1, [1959] Tex. Laws 187, *as amended*, ch. 441, § 1, [1963] Tex. Laws 1136.

⁴⁵ *Stanolind Oil & Gas Co. v. Terrell*, 183 S.W.2d 743 (Tex. Civ. App.—Galveston 1944).

⁴⁶ 447 F.2d 997 (5th Cir. 1971).

court relied on several Texas cases on agency⁴⁷ in holding that Jordan was Bankers' agent and that Bankers should suffer for the dishonest acts of its agent, rather than the innocent third party. Thus, Scurlock was not liable for conversion of Bankers' oil based on the acts of Jordan.

V. TAXATION

The Texas Supreme Court held in *Humble Oil & Refining Co. v. Calvert*⁴⁸ that the State of Texas has the power to collect oil and gas production taxes from an operator producing pursuant to a lease from the United States covering federal lands. Humble paid the state occupation tax⁴⁹ and regulation pipeline tax⁵⁰ under protest and then brought suit to recover the taxes, relying on the exemption of the national government from state taxation. The trial court held that the United States had abandoned its jurisdiction over the mineral estate when it granted an oil and gas lease to Humble. The court of appeals⁵¹ held that the United States had not abandoned the mineral estate, but that Congress had consented to the state taxation in the Buck Act.⁵²

The supreme court held that although an oil and gas lease under Texas law conveys a determinable fee estate, the effect of the execution by the United States of an oil and gas lease must be determined under federal law. Thus, the execution of the oil and gas lease did not constitute abandonment of the mineral interest. However, the Buck Act enables the states to impose certain taxes, including income taxes, within federal enclaves. An income tax is defined as any tax levied on, with respect to, or measured by, net income, gross income, or gross receipts.⁵³ The state did not contend that the regulation pipeline tax was a Buck Act income tax, and therefore, the court considered only the application of the Buck Act to the occupation tax. The court concluded that although the tax is called an "occupation tax" by the Texas statutes,⁵⁴ it is measured by gross receipts and therefore falls within the taxing authority permitted by the Buck Act.

VI. PROCEDURE

Two venue cases decided during the year should be mentioned. *Young v. McGill*⁵⁵ reiterates the accepted rule that an oil operator is not required to fence his well location to prevent injury to the surface owner's cattle. McGill sued Young in Andrews County for damages for the loss of some cattle that drank oil from around defendant's well. Young filed a plea of privilege to be sued in Tarrant County, and McGill filed a controverting affidavit alleging

⁴⁷ See *Harrison v. MacGregor*, 112 S.W.2d 1095 (Tex. Civ. App.—Amarillo 1938); *Wardlaw v. Pace*, 66 S.W.2d 350 (Tex. Civ. App.—Eastland 1933); *W.C. Biggers & Co. v. First Nat'l Bank*, 29 S.W.2d 841 (Tex. Civ. App.—Texarkana 1930), *error dismissed*.

⁴⁸ 478 S.W.2d 926 (Tex. 1972).

⁴⁹ TEX. REV. CIV. STAT. ANN. tit. 122A, arts. 3.01-11, 4.01-14 (1969).

⁵⁰ *Id.* art. 6032 (1962).

⁵¹ 464 S.W.2d 170 (Tex. Civ. App.—Austin 1971).

⁵² 4 U.S.C. §§ 105-10 (1970).

⁵³ *Id.* § 110(c).

⁵⁴ TEX. REV. CIV. STAT. ANN. tit. 122A, arts. 3.01(1), 4.02, 5.01 (1969).

⁵⁵ 473 S.W.2d 672 (Tex. Civ. App.—El Paso 1971).

venue in Andrews County under the negligence exception.⁵⁶ The negligence alleged was failure to fence the site, failure to repair the leak, failure to dispose of the leaking oil, and failure to make inspections. The court of appeals recognized the established rule that the operator of an oil and gas lease has no duty to fence around the well site; thus, since there was no duty, the petition raised no issue of negligence. The court further refused to take judicial notice of Railroad Commission rules which forbid oil on the surface.⁵⁷ There being no evidence in the record of unreasonable use of the surface or use of more surface than reasonably necessary, the court ruled that the plaintiff had not discharged his burden of supporting a cause of action in negligence.

The other case involved pooling.⁵⁸ The lessor sued the lessee in Matagorda County, alleging damages for breach of an implied covenant in an oil and gas lease covering land in Matagorda County. The lessee, two years after establishment of production on the lease, and after the end of the primary term, pooled a portion of the lease where a producing well was located with other lands. This reduced the royalty payable to the plaintiff from one-eighth to one-forty-eighth. The lessee filed a plea of privilege which was overruled. It was held that venue existed in Matagorda County under the exceptions for a contract in writing to be performed in a particular county⁵⁹ and fraud committed in the county where the suit is brought.⁶⁰

The lease provided for pooling for gas of up to 320 acres in order to comply with spacing rules, "or when, in lessee's judgment, it was necessary or advisable to do so in order to properly develop and operate the leased premises."⁶¹ Relying upon the implied covenant to do what a reasonably prudent operator would do under the same or similar circumstances as being a part of the written contract (*i.e.*, the lease), the court upheld venue under the written contract exception without the requirement of proof of the existence of a cause of action. The court further held that venue existed because of the fraud exception, assuming, in the absence of a statement of facts, that the plaintiff had a cause of action for breach of the lessee's fiduciary duty to exercise the utmost good faith when exercising the power granted under the pooling provision.

⁵⁶ TEX. REV. CIV. STAT. ANN. art. 1995, § 9a (1964).

⁵⁷ See Rules 7, 8, 20, Tex. R.R. Comm'n Rules & Regs. § 1, at 6, 15.

⁵⁸ *McCarter v. Ransom*, 473 S.W.2d 235 (Tex. Civ. App.—Corpus Christi 1971).

⁵⁹ TEX. REV. CIV. STAT. ANN. art. 1995, subd. 5 (1964).

⁶⁰ *Id.* § 7.

⁶¹ 473 S.W.2d at 237.