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site for piercing a corporate veil is the presence of some sort of inequity. Thus the only guidelines for the lawyer to employ in a piercing case are his sound reasoning and the facts of the case that might lead to a disregard of the corporate veil.

The other view is that the supreme court was by implication employing a two-pronged test[24]—showing of identity and, coupled with a showing that if such identity is allowed to continue, inequity will result. The court expressly asserted the settled law to be a list of inequities which if shown dictate piercing. These inequities may be likened to the second prong of the two-pronged test. The first prong, a showing of identity, was not mentioned by the *Bell* court, but the issue of identity may have been a mental element of its decision.

The two-pronged approach appears to be the better view. The issue of when to pierce under this test is more narrow and offers more certainty than does merely balancing the equities in each case; yet the approach is sufficiently general to be functional. Under the two-pronged test, the general guide for each case would be clear and each judge and jury could fit the facts into the guide for a determination of when to pierce. In addition, under the two-pronged test the law would be more uniform in its meaning and application to Texas corporations.

David L. Jackson

Determination of "Market Price" Under a Natural Gas Lease: The Vela Decision

In 1933 lessors executed an oil and gas lease providing for a royalty payment of "one-eighth of the market price at the wells" on gas sold or used off the premises. In 1935 lessees entered into a gas sales contract with a purchaser. Under this contract the purchaser agreed to pay a price of 2.3 cents per m.c.f.[1] of gas for the duration of the lease. During the years subsequent to the execution of the contract, additional production was commenced in the area by other lessees. These lessees were able to negotiate gas sales contracts at a price substantially above the 1935 contract price. The royalty owners sought to recover royalty deficiencies, alleging that the royalty payments should have been based on the current market price of the gas in the area and not on the 1935 contract price. *Held*: The "market price" for gas royalty purposes is to be determined from an analysis of contract prices currently negotiated in the area, not by the price received under a long-term sales contract. *Texas Oil & Gas Corp. v. Vela*, 429 S.W.2d 866 (Tex. 1968).

[24] *See* Pelletier, *Corporations, Annual Survey of Texas Law*, 21 Sw. L.J. 134, 142 (1967). *See also* notes 11, 12 *supra*, and accompanying text.

[1] An abbreviation for one thousand cubic feet.

I. Lease Royalty Clauses and Gas Sales Contracts

The typical oil and gas royalty clause provides that a share of all oil produced be delivered in kind to the royalty owners[2] and that a fractional share of the value or of the proceeds of sale of any gas produced be paid the owner-lessor of the property. This fractional share commonly is expressed in terms of one-eighth of the market price, value, or proceeds.[3]

Numerous controversies have arisen with reference to the meaning and application of the terms "market price" and "market value" in the process of determining the amount of gas royalty due the lessor.[4] Such disputes have led one writer to conclude that "the ordinary royalty clause pertaining to gas is one of the most ambiguous and incomplete provisions of an oil and gas lease ever to be brought before the courts."[5] These disputes usually have been the outgrowth of a long-term gas sales contract. The business practicalities of the natural gas industry require that gas be sold under long-term contracts with pipeline companies because the pipe lines must have a committed source of supply sufficient to justify financing, construction, and operation.[6] Since typical gas sales contracts are of substantial duration, the contract price terms may become onerous when compared to more favorable currently negotiated contract prices.

II. Royalty Clauses Which Measure Royalty in Terms of "Market Price" of Gas Sold

A precise definition of the term "market price" is difficult.[7] The market price of a normal commodity is what the commodity is actually sold for in an open market between willing sellers and willing buyers.[8] However, when the nature of the commodity is such that it can be marketed only through restricted channels (*e.g.*, the gas industry's long-term sales contract) a court attempting to construe a lease containing the term "market price" should be realistic in ascertaining the purpose and interest of the parties.[9]

Texas courts have been reluctant to set forth a rule for determining the

[2] Sheffield v. Hogg, 124 Tex. 290, 77 S.W.2d 1021 (1934).

[3] 3 H. Williams & C. Meyers, Oil & Gas Law § 650, at 633 (1964). The amount of the royalty on oil and gas produced is subject to negotiation between the parties to the lease and may vary with the circumstances in which the lease is executed. *See generally id.* § 642, at 501.

[4] Tyson v. Surf Oil Co., 195 La. 248, 196 So. 336 (1940); Katschor v. Eason Oil Co., 178 Okla. 634, 63 P.2d 977 (1937). *See also* H. Williams, R. Maxwell & C. Meyers, Cases and Materials on the Law of Oil and Gas 295 (1956).

[5] Sneed, *Value of Lessor's Share of Production Where Gas Only Is Produced*, 25 Texas L. Rev. 641, 656 (1947).

[6] Foster v. Atlantic Ref. Co., 329 F.2d 485 (5th Cir. 1964); Philips Petroleum Co. v. Bynum, 155 F.2d 196 (5th Cir. 1946); Gex v. Texas Co., 337 S.W.2d 820 (Tex. Civ. App. 1960).

[7] *See* Sneed, *supra* note 5, at 643-52.

[8] American Ref. Co. v. Sims Oil Co., 282 S.W. 894, 896 (Tex. Civ. App. 1926), *aff'd on other grounds*, 288 S.W. 163 (Tex. Comm'n App. 1926).

[9] Philips Petroleum Co. v. Ochsner, 146 F.2d 138, 141 (5th Cir. 1944); Hemler v. Union Producing Co., 40 F. Supp. 824, 832-33 (W.D. La. 1941), *rev'd on other grounds*, 134 F.2d 436 (5th Cir. 1943). Note Foster v. Atlantic Ref. Co., 329 F.2d 485, 488 (5th Cir. 1964), where the jury determined that no pipeline or other purchaser will buy large quantities of gas on a day-to-day or other short-term basis. However the court found this conclusion immaterial since it interpreted the claims as not being based on short-term fluctuations in price.

"market price" of gas under a lease,[10] but decisions in other jurisdictions have attempted to establish a workable definition and application of the term. In *Shamrock Oil & Gas Corp. v. Coffee*,[11] where the oil and gas lease provided for royalties measured by the market price of gas at the well, "market price" was determined by considering numerous other sales in the same field during the period involved. In *Philips Petroleum Co. v. Bynum*[12] the Fifth Circuit held that the term "market price at the well" means the price that gas of the same quality generally brings at the mouth of the wells in the same field. "Market price" was determined in another case from all evidence in the same field.[13] The Louisiana supreme court has more clearly defined "market price" not as an arbitrary price fixed by the lessee, but as the price actually given in contiguous area market dealings.[14] Several other decisions have stated that the "evidence" of the "market price" at a specific well is the market price which prevails over the contiguous area.[15]

The problem of *when* to apply the definition of "market price" also has created difficulty if there have been substantial gas price increases in the same area between the time of the signing of the gas sales contract and the time of litigation.[16] In *Foster v. Atlantic Refining Co.*[17] the Fifth Circuit resolved this difficulty by concluding that "market price" was to be determined at the time of sale, which it determined to be the time of delivery and not the time when the sales contract was signed.

III. Texas Oil and Gas Corp. v. Vela

In *Vela* the royalty owners contended that "market price" should be determined by current prices in the area rather than by the 1935 contract price.[18] The lessees countered with the argument that gas is not sold on a day-to-day basis, that any substantial volume can be marketed only under a long-term contract that fixes the price to be paid throughout the entire

[10] Texas Oil & Gas Corp. v. Vela, 405 S.W.2d 68, 73 (Tex. Civ. App. 1966), *aff'd*, 429 S.W.2d 866 (Tex. 1968).

[11] 140 F.2d 409 (5th Cir. 1944).

[12] 155 F.2d 196 (5th Cir. 1946).

[13] Union Producing Co. v. Pardue, 117 F.2d 225, 227 (5th Cir. 1941). New York courts have defined market price as the current price. *See* Sloan v. Baird, 162 N.Y. 327, 56 N.E. 752, 753 (Ct. App. 1900).

[14] Wall v. United Gas Pub. Serv. Co., 178 La. 908, 152 So. 561 (1934).

[15] Sartor v. United Gas Pub. Serv. Co., 84 F.2d 436 (5th Cir. 1936); Arkansas Natural Gas Co. v. Sartor, 78 F.2d 924 (5th Cir. 1935).

[16] *See* Weymouth v. Colorado Interstate Gas Co., 367 F.2d 84 (5th Cir. 1966), and J. M. Huber Corp. v. Denman, 367 F.2d 104 (5th Cir. 1966), two Texas gas royalty valuation cases, where long periods of time existed between the execution of the contract and the beginning of litigation. The market value royalty clause in the oil and gas lease was challenged due to the interstate sale of gas. The principal issue revolved around the fact that, since the FPC has the authority to fix prices on sale of gas in interstate commerce, it was possible that this would have the effect of changing the gas royalty clause in the lease between the parties and require that the royalty payment to the lessor be computed on the basis of the price fixed by the Federal Power Commission as the price the lessee receives, rather than on the basis of the market price or market value of the gas in the field where it is produced. The cases were remanded for a determination of FPC jurisdiction. Note, F.P.C. Primary Examiner's Initial Decision, July 23, 1968, 28 Oil & Gas Rptr. 667, which affirmed FPC jurisdiction. (The final FPC position is not available as of this writing.)

[17] 329 F.2d 485 (5th Cir. 1964).

[18] Texas Oil & Gas Corp. v. Vela, 429 S.W.2d 866, 870 (Tex. 1968).

term, and that the parties were aware of these facts when they made the lease. Thus, they argued, "market price" of gas within the meaning of the lease should be the price contracted for in good faith by the lessee in pursuance of its duty to market the gas.

The Texas supreme court treated the problem as one of defining "market price" and rejected the lessees' argument. A majority of five held that since none of the royalty owners had agreed to accept royalties according to the price stipulated in the long-term gas contract, the royalties to which they were entitled must be determined from the provisions of the original lease. Under the lease terms the lessee agreed to "pay the lessor, as royalty for gas from each well . . . one eighth of the market price at the well of the amount so sold or used."[19] The majority concluded that this language established the moment of sale or use to be the moment of physical delivery.[20] On this basis, the supreme court held that the price received under a long-term sales contract was not controlling in determining "market price." Rather, "market price" is to be determined by evaluating the contiguous and comparable sales in the same field at the time of delivery.

In reaching its decision the majority relied on the Fifth Circuit case of *Foster v. Atlantic Refining Co.*,[21] which held that a long-term contract did not modify the lessee's royalty obligation. In *Foster* the court stated that "[w]hen it made the gas sales contract, [lessee] took the calculated risk of that contract producing royalties satisfactory to the lease terms. The fact that increases in market price have made the lease obligation financially burdensome is no defense."[22] In relying on this decision, the Texas supreme court apparently was convinced that royalties based on "market price" could not be defined to mean royalties based on "proceeds." The majority indicated that if the parties had intended that royalties be based on "proceeds," they would have manifested this intention by agreeing that the royalty on gas produced would be a fractional part of the amount realized by the lessee from its sale.

The opinion of the four dissenting judges indicates that they felt the problem was not one of defining "market price" but rather one of deciding *when* to apply the definition. The dissent stated that "since it appears that the royalty provision fails to state as of what time the 'market price' is to be determined, . . . we must look to common practices in the industry at the time the lease contract was made in 1933 to ascertain what was the intention of the parties with reference to this matter."[23] Since at the time the parties signed the lease, long-term gas sales contracts commonly were employed, it was urged that the parties must have known that the

[19] *Id.* at 870-71.

[20] *Id.* at 871. *See* Martin v. Amis, 288 S.W. 431, 433 (Tex. Comm'n App. 1926). This case established that gas which was marketed under a long-term contract was not "being sold" at the time the contract was made but at the time of the delivery to the purchaser. *But cf.* Seabrook Ind. School Dist. v. Brown, 195 S.W.2d 828, 830 (Tex. Civ. App. 1946), *error ref.*, where the word "sold" was held not necessarily in all connections to mean that a conveyance must be made or that title must pass.

[21] 329 F.2d 485 (5th Cir. 1964). *See* note 17 *supra*, and accompanying text.

[22] *Id.* at 489.

[23] Texas Oil & Gas Corp. v. Vela, 429 S.W.2d 866, 879 (Tex. 1968).

term "market price" necessarily meant the price prevailing at the time the long-term contract was signed. The dissent admitted that a "sale" was not completed until the gas was delivered, but nevertheless contended that the price clause of the original contract of sale, if fair and reasonable when made, should control since "it took both the contract of sale and its delivery to constitute the sale."[24]

The dissenting judges further observed that the royalty clause in the *Foster* lease, unlike the *Vela* lease, required payment according to the "market price" in the field when the gas was run. They felt that the Fifth Circuit would not have reached the same result if the *Foster* royalty provision had not contained the words "when run."[25] In the view of the dissent, the parties in *Foster* had contracted effectively against long-term gas sales contracts, and "clearly and unambiguously"[26] had obligated the lessee to pay royalties based on the market price existing on the date the gas was run. In *Vela*, the customary "when sold" provision was used, thereby distinguishing *Vela* from *Foster*.

IV. Conclusion

Vela apparently indicates that under the terms of a gas lease, current market prices rather than the contract sale price of gas will now be controlling in determining the "market price." The long-term factor, reaching back to distress price days,[27] may have been an influential factor in the court's decision. However, in striving toward an equitable result, the Texas supreme court may be limiting severely the business judgment of lessees as well as limiting the prompt making of long-term contracts after the discovery of gas. The lessee was liable under an implied covenant to market, and both the lessor and the lessee had knowledge of the business reality that gas almost invariably has to be marketed through long-term contracts rather than on a spot market basis.

The vulnerability of many leases subject to the *Vela* decision may be mitigated by a determination that the royalty owners are subject to FPC ratemaking, which is not related to market value.[28] Even if no FPC jurisdiction is involved, a small variation in clause language might become the means for reaching an opposite result.[29] To avoid vulnerability and ambiguity in the future it is suggested that if the lessee intends to allow the

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[24] *Id.*

[25] However it is unclear in *Foster* whether the "when run" provision was the controlling reason for the court's decision. It would seem that the "when run" provision was not the controlling reason for the court's decision because the same court in Huber v. Denman, 367 F.2d 104 (5th Cir. 1966), established the same results as that in *Foster* with a royalty clause containing no mention of the term "when run." Although the court reached the same conclusion as that reached in *Foster* and *Vela* concerning market price, a different final result was reached due to possible FPC jurisdiction (*see* note 16 *supra*). The *Huber* gas royalty clause reads as follows: "to pay the lessors for one-fourth of the gas produced at the mouth of the well . . . four cents per thousand cubic feet for the first ten years and thereafter the market price of such gas."

[26] Texas Oil & Gas Corp. v. Vela, 429 S.W.2d 866, 880 (Tex. 1968).

[27] 29 Oil & Gas Rptr. 150 (1968).

[28] *See* notes 16 and 25 *supra*.

[29] *See* Skelly Oil Co. v. Harris, 352 S.W.2d 950 (Tex. 1962); *cf.* Gulf Oil Corp. v. Reid, 161 Tex. 51, 337 S.W.2d 267 (1960).