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Oil, Gas, and Mineral Law

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THIS Article focuses on the interpretations of, and changes relating to, oil, gas and mineral law in Texas from October 1, 1995 through September 30, 1996. The cases examined include decisions of courts of the State of Texas and the Fifth Circuit Court of Appeals.¹

II. CONVEYANCING ISSUES

Temple-Inland Forest Products Corp. v. Henderson Family Partnership, Ltd.² is a case on the mineral/royalty distinction which finds that the deeds in question reserved a 1/16 mineral interest stripped of appurtenant rights other than the right to receive royalties, rather than a 1/16 fixed royalty interest. The deeds first clearly conveyed an undivided 15/16ths of the minerals, and then recited: “In respect to the undivided one-sixteenth (1/16th) part of and interest in the oil, gas and other minerals retained and reserved by the Grantor in said land, it is understood and agreed that said one-sixteenth (1/16th) interest is and shall always be a

² 911 S.W.2d 531 (Tex. App.—Beaumont 1996, writ requested).
royalty interest . . . .”3 The deeds go on to convey to the grantee as to the reserved interest: (1) the right to develop, (2) the right to lease, (3) the right to bonus, and (4) the right to delay rentals. Thus, of the five attributes of a mineral interest, grantor retained only the right to receive royalty. The issue then was whether this bare royalty right was an attribute of a reserved mineral interest, or a 1/16 fixed royalty.

The court cited French v. Chevron U.S.A. Inc.4 for the proposition that a conveyance of a mineral interest with reservations of all of the attributes of a mineral interest, except the right to receive royalty, was still a conveyance of a mineral estate. The court then concluded that these deeds were simply the reverse of that same circumstance. That is, the grantors reserved a mineral estate and conveyed all of the attributes of a mineral estate, except the right to receive royalty. Therefore, the interest reserved was still a mineral interest.5 In support of its construction, the court relied upon the “four corners rule” and the rule that “a deed should be construed against the grantor.”6 As to the express recitals in the deeds that the “interest is and shall always be a ‘royalty interest,’” the court held that such a reference “cannot serve to create a royalty interest without an express reference to royalties for actual production of minerals . . . .”7 This was the controlling factor in Watkins v. Slaughter8 and French.9 The dissent believes that Watkins presented the identical issue and argued that the reserved interest was a 1/16th royalty.10

Russell v. City of Bryan11 considered whether the successors-in-interest to the grantor under an instrument conveying land for use as a park retained the mineral rights. The deed of dedication recited:

That I, Tyler Haswell . . . subject to the conditions hereinafter set out, do hereby Dedicate, and by these presents have Dedicated unto the City of Bryan . . . the following described tract . . .

* * *

The purposes and conditions of Dedication are as follows:

1. That said tract of land is to be used for a park and play-ground for the people of the City of Bryan, under such rules and regulations as may be prescribed . . . .12

The instrument goes on to describe certain conditions under which ownership might revert to Haswell and his successors. The principal condition is the failure of the city to use the land as a park.

The court held that the use of the term “dedicate” alone fails to estab-

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3. Id. at 532.
4. 896 S.W.2d 795 (Tex. 1995).
5. Temple-Inland, 911 S.W.2d at 534.
6. Id. at 534-35.
7. Id. at 535.
8. 144 Tex. 179, 189 S.W.2d 699 (1945).
9. 896 S.W.2d at 797.
10. Temple-Inland, 911 S.W.2d at 537.
11. 919 S.W.2d 698 (Tex. App.—Houston [14th Dist.] 1996, writ denied).
lish, as a matter of law, Haswell’s intent to grant only an easement.\textsuperscript{13} There are cases under other circumstances holding that a “dedication” may convey a fee or may convey an easement only.\textsuperscript{14} However, having previously determined that the Haswell deed was ambiguous, the jury’s finding that Haswell did not intend to convey only the surface was controlling.\textsuperscript{15}

\textit{Eland Energy, Inc. v. Rowden Oil & Gas, Inc.}\textsuperscript{16} involved a farmout under which the Farmee was obligated to reconvey the entire drilling lease at the end of the drilling program, except for “40 acres in the form of a square as nearly as possible” in a restricted depth around each producing well.\textsuperscript{17} Farmor conveyed the entire lease to Farmee, subject to the farmout agreement.\textsuperscript{18} The court apparently assumed that the Farmee was to designate the forty-acre units.\textsuperscript{19} A long time elapsed after the completion of the last well. Farmee refused to make the reconveyance, contending that the statute of limitations had run on the obligation to reconvey and that “40 acres in the form of a square as nearly as possible” around each well was unenforceable under the statute of frauds, because the lands were not sufficiently described. Farmor sued for declaratory relief and to quiet title.

The court held that Farmee was obligated to reconvey the lease, except as to the forty-acre tracts designated around each well.\textsuperscript{20} Farmee contended that the lease assignment conveyed the complete title with a covenant to convey back the forty-acre units. Because more than four years had elapsed since the last well was completed, Farmee argued that the action was time barred. The court rejected this argument and held that the Farmor always held the equitable title, i.e., the right to legal title as to all lands outside the forty-acre units.\textsuperscript{21} Because Farmor never gave up its title, this was not an action for specific performance to convey land, but an action to clear title, which is not subject to the four-year statute of limitations.\textsuperscript{22}

Although it was not entirely clear under the facts whether Farmor or Farmee was to designate the forty-acre tracts, in response to Farmee’s challenge that the forty-acre tracts were unenforceable legal descriptions, the court held that the right to make the designation was an equitable right in Farmee to perfect title by selecting the boundaries of each forty-acre tract earned.\textsuperscript{23} The right to designate is a right that may be lost by delay, but under the facts of this case, Farmee’s delay was not fatal. The

\begin{itemize}
\item \textsuperscript{13} \textit{Russell}, 919 S.W.2d at 703.
\item \textsuperscript{14} \textit{Id.}
\item \textsuperscript{15} \textit{Id.} at 703-04.
\item \textsuperscript{16} 914 S.W.2d 179 (Tex. App.—San Antonio 1995, writ denied).
\item \textsuperscript{17} \textit{Id.} at 182.
\item \textsuperscript{18} \textit{Id.}
\item \textsuperscript{19} \textit{Id.} at 187.
\item \textsuperscript{20} \textit{Id.} at 186.
\item \textsuperscript{21} \textit{Id.}
\item \textsuperscript{22} \textit{Id.}
\item \textsuperscript{23} \textit{Id.} at 187.
\end{itemize}
right to make the designation, coupled with an interest in doing so, satisfies the requirements of the statute of frauds.\textsuperscript{24}

This case is significant because it is quite common to see farmouts and other similar agreements with reconveyance obligations and rights to earn couched in similar terms. The practice pointer would seem to be that “agreements to transfer” are safer for the Farmor than “conditional assignments,” but even conditional assignments are probably safe if made subject to the farmout agreement. As to the “40 acres in the form of a square as nearly as possible” legal description, some additional language could add some additional assurance that the legal description is enforceable. For example, the description could add “centered on the well with the boundaries parallel to the boundaries of Section ________.” It should be made clear whether Farmor or Farmee has the right to describe the forty-acre tract.

III. OIL, GAS AND MINERAL LEASES

A. PUGH CLAUSE

The lease involved in \textit{Geotrac Energy Corp. v. Gottschalk}\textsuperscript{25} contained a typical habendum clause in the printed form: “for a term of 3 years from this date (called ‘primary term’) and as long thereafter as oil, gas or other mineral is produced from said land hereunder.”\textsuperscript{26} The printed form habendum clause was then modified by an addendum which read:

Provided this lease is held by production at the expiration of the primary term, Lessee will have one (1) year after the expiration of the primary term to drill an additional well, and if no such well is drilled, then this lease will expire except to forty (40) acres around each producing oil well and eighty (80) around each gas well. Two producing wells will hold the entire leasehold described herein.\textsuperscript{27}

The lessee drilled a producer and a dry hole within the primary term. Within a year after the primary term expired, lessee drilled another dry hole. Lessor contended that the lease had terminated because of lessee’s failure to drill two producing wells. Lessee contended that one producing well and the additional well it drilled after the expiration of the primary term were all that was required to hold the entire lease.\textsuperscript{28}

A decision for the lessor in the trial court on competing motions for summary judgment was reversed and rendered on appeal. Neither party contended the lease was ambiguous, and the court followed several well-established general rules of construction in interpreting the lease. However, the two rules which the court found most persuasive are uniquely applicable to oil and gas leases. “Language used by parties to an oil and

\textsuperscript{24} Id.

\textsuperscript{25} No. 03-95-00538-CV, 1996 WL 211016 (Tex. App.—Austin May 1, 1996, writ denied) (withdrawn from publication).

\textsuperscript{26} Id. at *1.

\textsuperscript{27} Id.

\textsuperscript{28} Id. at *2.
gas lease will not be held to impose a special limitation on the grant unless it is clear and precise and so unequivocal in nature that it can reasonably be given no other meaning.

If the language of an oil and gas lease "is reasonably susceptible of a construction argued for by one of the parties, that prevents a forfeiture, such construction is to be preferred to one resulting in a forfeiture." Applying these two rules, the court accepted lessee's construction as offering an alternative that preserved the lease and which was a reasonable interpretation of the addendum, which itself did not "clearly, precisely and unequivocally" terminate the lease.

B. Royalty Clause

_Heritage Resources, Inc. v. NationsBank_32 clarifies the evolution of the law pertaining to division orders and makes definitive some of the law pertaining to the deductibility of post-production costs from royalty. The leases involved differed in some respects, but each required that the royalty for gas sold or used off the premises be based on "market value at the well" and further provided that "there shall be no deductions from the value of Lessor's royalty by reason of any required processing, cost of dehydration, compression, transportation or other matter to market such gas." Heritage sold gas off the leased premises. Heritage deducted the cost to transport the gas from the wellhead to the point of sale as a post-production cost from the sales price before calculating royalties. NationsBank sued Heritage contending that Heritage deducted transportation costs from the value of NationsBank's royalty in violation of the leases, although NationsBank conceded that the transportation costs deducted were "reasonable." The contested issue was whether Heritage could deduct any transportation costs.

Royalty is usually subject to a proportionate part of post-production costs, including taxes, treatment costs to render the production marketable, and transportation costs. Heritage contended that the royalty clause defined the lessor's royalty as a fraction of the market value at the well, and therefore reasonable transportation costs should be deducted. NationsBank argued that the lease language specifically prohibited this deduction. The court of appeals agreed with NationsBank and reasoned that Heritage's interpretation would render the post-production clause meaningless.

The supreme court agreed that the post-production clause was meaningless, but because the clause was "surplusage as a matter of law."35 It

32. 939 S.W.2d 118 (Tex. 1996).
33. _Id._ at 120.
35. _Heritage Resources_, 939 S.W.2d at 123.
held that “royalty” and “market value at the well” have commonly accepted meanings in the industry, and by applying those meanings, the post-production clause merely restated existing law.\textsuperscript{36} The case is significant and is likely to be frequently cited for expressly defining these common industry terms. Those definitions are:

Royalty is commonly defined as the landowner’s share of production, free of expenses of production. Although it is not subject to the costs of production, royalty is usually subject to post-production costs, including taxes, treatment costs to render it marketable, and transportation costs. However, the parties may modify this general rule by agreement.

Market value at the well has a commonly accepted meaning in the oil and gas industry. Market value is the price a willing seller obtains from a willing buyer. There are two methods to determine market value at the well.

The most desirable method is to use comparable sales. A comparable sale is one that is comparable in time, quality, quantity, and availability of marketing outlets.

Courts use the second method when information about comparable sales is not readily available. This method involves subtracting reasonable post-production marketing costs from the market value at the point of sale. Post-production marketing costs include transporting the gas to the market and processing the gas to make it marketable. With either method, the Plaintiff has the burden to prove market value at the well. [citations omitted].\textsuperscript{37}

In this particular case, the commonly accepted meanings of these terms in the industry operated to defeat NationsBank’s claim. The court reasoned that because the royalty payable was based on “market value at the well” (which necessarily included deductions for post-production costs), a subsequent recital that the “value of the Lessor’s royalty” was not reduced by deductions for post-production costs merely restated existing law.\textsuperscript{38} Nevertheless, because the opinion expressly recognizes that the meaning of “royalty” can be changed by agreement, a more artfully worded royalty clause could accomplish the result sought by NationsBank. For example, the result would have likely favored NationsBank if the post-production clause had read:

In determining market value at the well there shall be no deductions from the amount paid to Lessee by the first unrelated third-party purchaser by reason of any required processing, cost of dehydration, compression, transportation or other matter to market such gas, such costs to be borne solely by Lessee.

*Heritage Resources* is also an important division order case. In the El Paso Court, the division order issues were more important because Heritage’s first defense (post-production costs are deductible under the roy-

\textsuperscript{36} Id. at 122.
\textsuperscript{37} Id. at 121-22.
\textsuperscript{38} Id. at 123.
alty clauses) failed, and it urged a second defense based on division orders, which allowed the deduction of transportation costs. In the supreme court the provisions of the division orders were no longer as important, because those provisions were essentially consistent with the royalty clauses in the leases, under the interpretation given to the royalty clauses by Heritage and by the supreme court. Nevertheless, the supreme court expressly disapproved of portions of the El Paso Court's opinion which conflicted with Gavenda v. Strata Energy, Inc.\(^3\)

The Heritage Resources opinion clarifies the result when division orders prepared by the operator incorrectly allocate payments among the interest owners in a manner that differs from the lease provisions, and the operator retains a benefit. The division orders are not binding and the operator is liable for the benefit retained, but only the benefit retained, under the principle of unjust enrichment.\(^4\) In other words, the lessee who overpays himself at the expense of the royalty owner signing the division order cannot hide behind the division order. If the wrongful payment has gone to someone else, the lessee can hide behind the division order. Any other result would defeat the utility of the division order in expediting payments and would further delay the orderly resolution of title issues. This part of the decision should be very helpful in reducing the confusion about the effectiveness of division orders. To recover any payments made under a division order prior to revocation, the remedy must be pursued against the party who ended up with the money, and a claim can be pursued against that party only to the extent of the money that party received. It is a bright line, a distinctive line, and fits within the well-established legal doctrine of unjust enrichment.

In clarifying the effect of division orders, the decision is a good one. It is hard to see how any party could complain. Don't sign a division order and accept benefits, unless you are sure of your own interest. Once payments are made, you cannot recover for an underpayment against anyone except the party receiving the unjust enrichment. In regards to "market value" and "post production costs," this case will be dissected by lawyers for years. In an era of gathering system spinoffs and increasing gathering

\(^3\) 705 S.W.2d 690 (Tex. 1986), cited in Heritage Resources, 939 S.W.2d at 123.

\(^4\) Heritage Resources, 939 S.W.2d at 123. In the Gavenda opinion, the case was remanded for a determination of the amount of royalty owed by Strata and the other working interest owner. Strata was only liable for whatever portion of the royalties it retained and was not liable for any royalties it paid out to other owners. Gavenda, 705 S.W.2d at 692-93. Thus, Gavenda stands for the premise that, if the issuer of the division order makes a mistake in the issuer's favor (and does not pay it over to another), then the issuer must give up its unjust enrichment to the rightful owner. Presumably, the same recovery based on unjust enrichment would be available against any overpaid party. The critical fact issue is to determine who received the overpayment. This simple concept was unfortunately and unnecessarily confused by a poorly reasoned opinion on remand in Strata Energy, Inc. v. Gavenda, 753 S.W.2d 789 (Tex. App.—Houston [14th Dist.] 1988, no writ), which held that the operator was liable for overpayment made to overriding royalty owners, because it was a benefit "retained" by the working interest owner, although the money was paid out to the overriding royalty owners. The Heritage opinion effectively disapproves the opinion on remand in the Gavenda case on this issue.
costs, this will be an area of litigation for some time. The opinion clearly
does the industry a service by adopting in the highest court of the state a
principle that was widely believed to have been resolved: unless other-
wise agreed, market value at the well means net of post production costs.
Whether this particular lease royalty clause did or did not amount to
“otherwise agreed” is a closer question, but the underlying principles are
sound.

In Judice v. Mewbourne Oil Co., Mewbourne deducted a pro rata
part of post-production compression costs from lessor’s royalty. The royalty under the leases was to be a fractional part of the “market value at
the well” of the gas produced. Relying upon Heritage Resources, supra,
decided the same day, the court held that under a market value royalty
clause the royalty is payable net of any value added by compressing the
gas after it leaves the wellhead. Therefore, Mewbourne was entitled
under its leases to allocate to the royalty owners their proportionate
share of the reasonable costs of post-production compression.

Having settled the meaning of the royalty clause with respect to post-
production compression costs, the court turned to the effect to be given to
division orders executed by the lessors. One form of division order pro-
vided that settlement was to be based on “net proceeds realized at the
well” and deleted all of the rest of the form, which expressly allowed
dedications for compression costs. The court ruled that “net proceeds”
expressly contemplates deductions and that its interpretation of “at the
well” means before value is added by preparing the gas for market. The
handwritten deletions did not change what was left in the division order,
so that under this division order, compression costs were deductible. A
second form of division order provided that settlement was to be based on “gross proceeds realized at the well.” The court concluded this form
was ambiguous and allowed to stand a jury finding that the parties in-
tended that royalty was to be payable without deductions for compression.

C. Top Leases

Hamman v. Bright & Co. holds that a top lease violates the Texas
constitutional rule against perpetuities (the “Rule”), which provides that
“[P]erpetuities . . . are contrary to the genius of free government, and
shall never be allowed.” Under the Rule, no interest is valid unless it

42. Id. at *3.
43. Id. at *4.
44. Id. at *4-5.
45. Id. at *5-6.
46. Id. at *7.
47. Id. at *5.
48. Id. at *8.
49. 924 S.W.2d 168 (Tex. App.—Amarillo 1996, writ granted).
must vest, if at all, within twenty-one years after the death of some life or
lives in being at the time of the creation of the interest.51 The court is
careful to say that it does not hold that all top leases violate the Rule,
only that these particular top leases violated the Rule.52

The Hamman Ranch was leased in 1951 and 1952 and then top leased.
These top leases provided:

[T]his lease shall be for a term and period (now called “primary
term”) covering and embracing, and including also, ten (10) years
after and subsequent to the forfeiture, or to the expiration, of said
lease [bottom leases] . . . .

It being particularly agreed and understood that during the exist-
ence and continuance of said prior lease that the rights, interests,
estate, privileges and royalties, as fixed thereby, of said Lessors shall
remain vested in and held and possessed by said Lessors, free of all
claims and demands whatsoever . . . .53

The Rule is not applicable to present interests or future interests which
vest at their creation, so that the challenged top leases must be examined
as of the date the instruments were executed.54 The top leases are void,
if, by any possible contingency, the interest could vest outside the perpe-
tuities period.55 The court reasoned that a lease creates a fee simple de-
terminable estate in the minerals, leaving a possibility of reverter in the
lessor.56 The possibility of a reverter is freely assignable, and because it is
a presently vested interest, it is not subject to the Rule.57

However, an executory interest which cannot vest until a condition pre-
cedent occurs may be void under the Rule.58 The court concluded that
the language in these top leases evidenced an intent that the lessors
would remain fully vested with the possibility of reverter until the termi-
nation of the bottom leases.59 Because the top leases had the potential
for vesting outside the period provided by the Rule, the top leases were
void ab initio as future conveyances of springing executory interests.60

The top leases had been expressly ratified, but the court held that “[a]n
agreement made in violation of the constitution or a statute is illegal and
absolutely void, and is not subject to ratification.”61 Therefore, top leases
void ab initio under the Rule cannot be ratified.62 From the opinion it is
not possible to tell how all the facts played out in this case, but it is easy
to imagine the significant economic issues which might arise if a void top

51. Hamman, 924 S.W.2d at 171.
52. Id. at 173 n.4.
53. Id. at 172.
54. Id. at 171.
55. Id.
56. Id.
57. Id.
58. Id.
59. Id. at 172.
60. Id. at 170, 172-173.
61. Id. at 174.
62. Id.
lease (even a ratified void top lease) is challenged after production is obtained, and the lease is void \textit{ab initio}.

Shortly after the top leases were granted, certain mineral interests were conveyed by a deed reserving a perpetual one-sixteenth royalty interest in the grantors. The conveyance was made subject to the bottom leases and the top leases, reserved one-half of the royalty payable thereunder, and "in event of the termination, forfeiture, or expiration of said leases, as and when same may, respectively, so terminate, forfeit, or expire, a perpetual non-participating free royalty interest..."\textsuperscript{63} The court relied upon \textit{Jupiter Oil Co. v. Snow}\textsuperscript{64} to find that the lessors under this subsequent mineral deed retained one-half of the royalty payable under the leases and the possibility of reverter.\textsuperscript{65} Out of the possibility of reverter, the grantors also retained the described perpetual non-participating free royalty interest, which did not violate the Rule.\textsuperscript{66}

D. \textbf{Surface Damages}

\textit{Oryx Energy Co. v. Shelton}\textsuperscript{67} is a surface damages case based on excessive use of surface rights under an oil and gas lease. Under the 1944 lease, the lessee drilled approximately fifty wells, and the suit complaining of excessive use, negligence and pollution was brought against Oryx in 1993. The trial court limited the claims against Oryx to actions of Oryx which occurred within the window permitted by the two-year statute of limitations.\textsuperscript{68}

The court found there was sufficient evidence to support the jury's finding that Oryx's use of the surface of the land was excessive.\textsuperscript{69} The court rejected the award of punitive damages, holding that there was no evidence that Oryx's conduct was willful, wanton or malicious while conducting its mineral operations.\textsuperscript{70} There was evidence of abandoned rusty equipment and pipelines, numerous oil and salt water spills, and the destruction of vegetation, but to recover, plaintiffs must produce evidence that the defendant "proceed[ed] with conscious indifference to the rights, safety, or welfare of others."\textsuperscript{71}

E. \textbf{Other Minerals}

\textit{TCA Building Co. v. Northwestern Resources Co.}\textsuperscript{72} reviews the validity of a ratification of a lignite mining lease that was void when originally

\begin{itemize}
  \item \textsuperscript{63} \textit{Id.}
  \item \textsuperscript{64} 819 S.W.2d 466 (Tex. 1991).
  \item \textsuperscript{65} \textit{Id.} at 468-69.
  \item \textsuperscript{66} \textit{Hamman}, 924 S.W.2d at 175.
  \item \textsuperscript{67} No. 12-94-00045-CV (Tex. App.—Tyler Nov. 26, 1996, no writ) (not designated for publication), 1996 WL 687025.
  \item \textsuperscript{68} \textit{Id.} at *1.
  \item \textsuperscript{69} \textit{Id.} at *4.
  \item \textsuperscript{70} \textit{Id.} at *5.
  \item \textsuperscript{71} TEX. CIV. PRAC. & REM. CODE ANN. § 41.001(7)(B)(ii) (Vernon Supp. 1996).
  \item \textsuperscript{72} 922 S.W.2d 629 (Tex. App.—Waco 1996, writ denied).
\end{itemize}
granted. The lessor acquired the land from the Veterans Land Board (VLB) under a purchase agreement which provided that title to the property remained with the VLB until an amount owing under the agreement was paid in full. Lessor leased the land to TU Electric in 1978 for a ten-year term to mine coal and lignite. TU also acquired an option under which it could pay to the VLB the remaining debt before the ten years were over, thereby divesting the VLB of ownership, and activating a 35-year option.\textsuperscript{73}

At the time the lease and option were agreed upon, leases on surface estates on VLB land for longer than ten years were prohibited, and all lease options of any length on VLB surface estates were also prohibited.\textsuperscript{74} In 1981, the law was amended to allow for lease terms of more than ten years on VLB land as well as for lease options.\textsuperscript{75} In 1983 TU Electric paid off the VLB debt, and in 1986 TU Electric assigned its rights to Northwestern. Northwestern became concerned about the possible invalidity of the lease, and in 1987 obtained a formal ratification from the lessor. The lessor then sold the property to TCA.

TCA contended that the lease was void \textit{ab initio}, but the court held that so long as the invalidating condition is removed and a valid ratification subsequently occurs, a previous void contract can be ratified.\textsuperscript{76} The holding did not address whether a mere change in law will automatically ratify a previously illegal contract; instead the holding rested solely on the ground that the express ratification of a previously illegal agreement subsequent to a change in the law that removes the illegality of the agreement validates the original agreement.\textsuperscript{77}

\section*{IV. DIVISION ORDERS}

The two most important division order cases, \textit{Heritage Resources} and \textit{Judice}, are discussed above in section III.B.

\textit{Mattalino v. Trinity Petroleum Exploration}\textsuperscript{78} considers the effect of the signing of a division order as a possible waiver. Mattalino developed prospects for Trinity in exchange for compensation that included an assignment of an overriding royalty interest. As to a particular prospect, Mattalino and Trinity had a dispute about the overriding royalty which should have been assigned. Before the litigation was filed, Mattalino signed division orders and accepted payments for several months without complaint. Trinity argued that the signing of a division order by an experienced oil and gas man like Mattalino, coupled with his acceptance of the reduced payments, waived his right to larger payments. The court held:

\begin{itemize}
  \item \textsuperscript{73} Id. at 632.
  \item \textsuperscript{76} \textit{TCA Building Co.}, 966 S.W.2d at 634.
  \item \textsuperscript{77} Id.
  \item \textsuperscript{78} 927 F. Supp. 986 (S.D. Tex. 1996).
\end{itemize}
While the Texas Division Order Statute does not support Trinity’s contention that Mattalino waived his contractual rights as a matter of law, signing the division order does count as evidence of an intent to waive one’s Rights. TEX. NAT. RES. CODE ANN. § 91.401(3) ([Vernon] 1978).

* * *

Without a factual dispute, the evidence of waiver is sufficient for summary judgment.79

V. EASEMENTS

In Valero Eastex Pipeline Co. v. Jarvis80 a pipeline condemned an easement expressly excepting the mineral rights, and, under the terms of the easement, obligated itself to relocate the pipeline in the event of coal and lignite mining activities.81 The trial court sua sponte removed the case from the jury and refused to award the landowner any damages because the taking was temporary. On appeal it was held that the pipeline was entitled to condemn whatever interest was necessary for public use, but it could not force the landowners to accept the pipeline’s promise to move its pipeline.82 A condemnor cannot make promissory statements regarding its future intentions, the effect of which is to prevent a landowner from recovering all damages in a single proceeding. The pipeline company and the landowner could agree that the pipeline company may from time to time remain liable for future damages, but the courts will not force such an agreement on landowners.83

VI. JOINT OPERATIONS

Mitchell Energy Corp. v. Samson Resources Co.84 considers the duties owed by a unit operator which fails to pay unleased cotenants and which fails to pay lessors. Samson operated a unit which produced about fifteen million dollars in gross revenues. Samson did not pay the owners of approximately 10% of unit production. Why Samson did not pay was a contested fact question at trial, but apparently the jury did not like Samson’s explanation. Samson was stuck with three million dollars in actual damages and fifty million dollars in punitives. The verdict was based on fraud and conversion.85

Mitchell was clearly an unleased cotenant. The jury found that certain intervenors were also unleased cotenants, because Samson had repudiated their leases by failing to pay royalties.86 The court found that mere nonpayment of royalty does not terminate an oil and gas lease, and that

79. Id. at 989.
80. 926 S.W.2d 789 (Tex. App.—Tyler 1996, writ denied).
81. Id. at 791.
82. Id. at 793.
83. Id.
84. 80 F.3d 976 (5th Cir. 1996).
85. Id. at 980-81.
86. Id. at 981.
the remedy for nonpayment lies in an action for damages based on contract.\textsuperscript{87} Therefore, the leases were still in effect and the intervenors were to be treated as lessors, not as unleased cotenants.\textsuperscript{88}

As to the intervening lessors, Samson had the right to take the production without being liable for conversion. It was equally certain that any cotenant has the right to extract minerals from the common property, without the consent of the cotenant and without being liable for conversion. The court could find no Texas case directly on point, but it went on to hold that one cotenant is not liable to another for the tort of conversion for failing to pay another cotenant the cotenant's share of the proceeds.\textsuperscript{89} The cotenant's remedy is a right to an accounting, which is not a tort remedy.\textsuperscript{90} Money can be the subject of conversion, but only when it is in the form of a specific chattel, such as old coins.\textsuperscript{91} Similarly, not paying the royalty owners was not conversion.\textsuperscript{92}

The other basis for a tort remedy was fraud. The finding of fraud was based on Samson's failure to disclose material facts, i.e., that Samson owed money. Absent a fiduciary or confidential relationship, the failure to disclose information is not actionable as fraud. Because under Texas law neither a cotenancy nor a lessor/lessee relationship imports a fiduciary relationship, the court reversed on fraud.\textsuperscript{93} Both tort claims having failed, the award of punitive damages was also reversed and vacated.\textsuperscript{94}

Samson's ultimate liability to its unpaid unleased cotenant was measured by the value of the gas produced less drilling and operating expenses. Liability to the royalty owners was measured by the royalty payments owed under the leases. Plaintiffs also recovered interest and attorney's fees.\textsuperscript{95}

\textit{Imco Oil & Gas Co. v. Mitchell Energy Corp.}\textsuperscript{96} involved multiple operating agreements on the same tract and multiple preferential rights to purchase. Mobil, Texaco and Getty were each parties to a 1945 operating agreement containing a preferential right to purchase. Westland earned certain deep rights from Mobil and Getty, subject to the 1945 operating agreement, and entered into a 1972 operating agreement with Mobil. The 1972 operating agreement contained preferential rights provisions identical to those in the 1945 operating agreement, and it was prepared with signature spaces for all the other parties who owned working interests in the field. Only Mobil and Westland signed the 1972 operating agreement. Mitchell acquired Mobil's interest. Before closing its sale to Mitchell, Mobil offered the property to Texaco (which had already acquired

\begin{itemize}
\item \textsuperscript{87} Id. at 982.
\item \textsuperscript{88} Id. at 982-83.
\item \textsuperscript{89} Id.
\item \textsuperscript{90} Id. at 983.
\item \textsuperscript{91} Id. at 984.
\item \textsuperscript{92} Id.
\item \textsuperscript{93} Id. at 984-85.
\item \textsuperscript{94} Id. at 987.
\item \textsuperscript{95} Id. at 988.
\item \textsuperscript{96} 911 S.W.2d 916 (Tex. App.—Fort Worth 1995, no writ).
\end{itemize}
Getty's interest) under the 1945 operating agreement, and then to Westland under the 1972 operating agreement. Both declined. Westland then tried to sell its interest to Imco. Mitchell exercised its preferential right under the 1945 operating agreement as acquired from Mobil. Imco sued to try and avoid the preferential right.\footnote{97
Id. at 918.}

Imco contended that the 1972 operating agreement was ineffective because the additional signature blanks showed that the intent of the parties was that the agreement was not to become binding unless signed by all of those for whom blanks were provided. The issue had not previously been addressed in Texas. Relying upon Florida authority, the court held that a contract not signed by all of the parties will be valid unless the nature or the wording of the contract indicates that it is not to become binding unless and until it is fully executed.\footnote{98
Id. at 920.} In this particular case, the court also pointed to language at the beginning of the operating agreement which referred to all of the signatory parties as evidence that the intent was to bind any signatory party.\footnote{99
Id.}

Imco also contended that the 1972 operating agreement was ineffective because its terms were inconsistent with the 1945 operating agreement. The 1945 agreement named Mobil as operator of the field. The 1972 agreement named Westland as the operator of the deep rights. The court reasoned that this was the same as Mobil hiring an independent contractor as operator, which would not relieve Mobil of its responsibilities to Getty and Texaco, but instead only created additional duties and responsibilities as between Mobil and Westland.\footnote{100
Id. at 919.} This was consistent with the 1945 agreement. Equally consistent was the sequence of the preferential rights. The 1945 agreement contained the prior right, but the 1972 preferential right was equally valid, although subordinate to the 1945 right.\footnote{101
Id.}

The case is significant in exploring the relationship between multiple operating agreements and multiple preferential rights to purchase. It is apparently a case of first impression on the binding effect of partially executed operating agreements. If an operating agreement is not to be binding unless fully executed, the practice pointer is to insert a recital that the agreement is not to be binding upon any party unless and until it is fully executed by all parties for whom signature blanks are provided.

\textit{Rogers v. Ricane Enterprises, Inc.}\footnote{102
930 S.W.2d 157 (Tex. App.—Amarillo 1996, writ denied).} was a decision written on remand under instructions to consider the conversion issues raised by Rogers. Production had occurred and had been taken by others from a property in which Rogers owned a working interest. The significant legal issue was to determine the applicable statute of limitations and whether the discovery rule applied. The court held that oil and gas once removed from the land becomes personalty and that conversion claims for personal prop-

\begin{footnotes}
\footnote{97
Id. at 918.}
\footnote{98
Id. at 920.}
\footnote{99
Id.}
\footnote{100
Id. at 919.}
\footnote{101
Id.}
\footnote{102
930 S.W.2d 157 (Tex. App.—Amarillo 1996, writ denied).}
\end{footnotes}
OIL, GAS, AND MINERAL LAW

PROPERTY are governed by a two-year limitations period which runs "not later than two years after the cause of action accrues."103

When a cause of action "accrues" is to be determined by the courts, and the traditional rule in Texas is that the two-year statute begins to run as soon as the owner suffers some injury, regardless of when the injury becomes discoverable. The general rule in conversion cases is that the limitations period begins to run at the time of the unlawful taking. However, if the original possession is not unlawful, the limitations period does not begin to run until demand for possession has been made and refused, or until the person in possession has unequivocally exercised acts of domination over the property inconsistent with the rights of the owner.104

Rogers contended that the running of limitations should be tolled during the period in which other issues of the case were being litigated. The court held that nothing prevented Rogers from simultaneously pursuing a conversion claim and that the two-year statute applied.105

Rogers contended that the discovery rule should apply. "The rule provides that a statute of limitations does not run from a fixed date, but from the time a plaintiff knew or should have known of the existence of facts sufficient to constitute a cause of action."106 The court expressly rejected Harrison v. Bass Enterprises Production Co.107 as authority for the proposition that a lower court cannot apply the discovery rule to a new set of facts until it has first been applied to a similar set of facts by our supreme court. The court relied heavily upon S.V. v. R.V.108 and quoted the following relevant excerpts:

Restated, the general principle is this: accrual of a cause of action is deferred in cases of fraud or in which the wrongdoing is fraudulently concealed, and in discovery rule cases in which the alleged wrongful act and resulting injury were inherently undiscernible at the time they occurred but may be objectively verified. This principle, while not expressed in every deferred accrual case, is derived from them and best defines when the exception to the legal injury rule has been and should be applied.

* * *

An injury is inherently undiscernible if it is by nature unlikely to be discovered within the prescribed limitations period despite due diligence.109

Because drilling and production was not concealed, the wells were openly located on the premises, documents were of public record, and evidence of production was not only available by visual inspection, but also

104. Id. at 166.
105. Id. at 167.
106. Id.
107. 888 S.W.2d 532 (Tex. App.—Corpus Christi 1994, no writ).
108. 933 S.W.2d 1 (Tex. 1996).
109. Rogers, 930 S.W.2d at 169.
through Railroad Commission filings, the court held that the discovery rule did not apply.\textsuperscript{110}

The court then analyzed the application of the two-year statute to the various defendants under the specific facts applicable to each defendant. The defendant under circumstances of most interest was the oil purchaser. Southern Union was the purchaser of the oil belonging to Rogers, but produced and sold by Torreyana. Rogers claimed that by purchasing the oil, Southern Union became a convertor. Southern Union claimed that it was a good faith buyer in the ordinary course of business and was not a convertor under the Texas Uniform Commercial Code (Texas UCC) and the jury findings.\textsuperscript{111} The court agreed with Southern Union and determined that for this defense to be applicable three elements must be present: "(1) an entrustment of goods to (2) a merchant who deals in goods of that kind, followed by a sale by such merchant to (3) a buyer in the ordinary course of business."\textsuperscript{112}

\section*{VII. GAS CONTRACTS}

\textit{Lenape Resources Corp. v. Tennessee Gas Pipeline Co.}\textsuperscript{113} considers whether "85\% of Seller’s delivery capacity" is a term sufficiently definite for a gas purchase contract to be enforceable, or whether the "gap filler" provisions of the uniform commercial code must be called upon to supply the quantity term.\textsuperscript{114} Tennessee, as purchaser, entered into a gas purchase contract with Lenape’s predecessor. This was a take-or-pay contract right out of the good old days of the last boom. The contract dedicated certain acreage and gave Lenape the discretion to drill more wells or to unitize the acreage. Lenape was not obligated to deliver any particular quantity, but Tennessee was obligated to take, or pay for if not taken, "85\% of Seller’s delivery capacity."\textsuperscript{115} When prices and demand fell, Tennessee began taking unilateral action in the form of refusing to take more than system demand or to pay prices above market. Threatened with litigation for failure to develop by its lessors, Lenape took action to cause additional drilling. The result was several new wells located on acreage dedicated to the contract or on acreage pooled with contract acreage. These new wells dramatically increased the volume of production and Tennessee’s potential liability for take-or-pay payments or for taking gas in excess of its needs.\textsuperscript{116}

Tennessee contended that "85\% of Seller’s delivery capacity" was too vague to be enforceable, but if it was enforceable, it was only because output and requirements contracts under Texas UCC section 2.306 are

\begin{thebibliography}{113}
\bibitem{id} Id.
\bibitem{id2} Id. at 170 (citing \textit{TEX BUS. \& COM. CODE ANN. \S 2.403(b), (c) (Tex. UCC)} (Vernon 1994)).
\bibitem{id3} Id. at 171.
\bibitem{id4} 925 S.W.2d 565 (Tex. 1996).
\bibitem{id5} Id. at 569-70.
\bibitem{id6} Id. at 569.
\bibitem{id7} Id. at 567-68.
\end{thebibliography}
made definite by reading into such contracts a quantity that is the actual good faith output or requirements of a particular party not unreasonably disproportionate to comparable prior output. Specifically, Tennessee contended that requiring it to take or pay for this huge increase in production would violate the good faith and proportionality requirements of section 2.306. Other cases had clearly held that when section 2.306 was applicable, no quantity unreasonably disproportionate to prior output could be tendered.

Section 2.306 applies only if (1) the contract is an output contract and (2) there is no express quantity term. Tennessee contended that the gas contract was an “output” contract because the quantity term was measured by Lenape’s delivery capacity. The court concluded that a take-or-pay contract is not an “output” contract because an output contract is one in which the buyer agrees to buy the seller’s entire output. The “pay” option under a take-or-pay option does not require the buyer to take any gas. Thus, the buyer largely determines the quantity to be taken.

The supreme court also rejected Tennessee’s claim because there was an express quantity term. Section 2.306 is a gap-filler and may be varied by the parties’ agreement. It fills in the quantity term only when a contract does not unambiguously specify the quantity of the output of the seller or the requirements of the buyer. This contract required Tennessee to purchase a set quantity of gas produced from the committed reserves, which was defined as 85% of Lenape’s delivery capacity. The court found that this quantity was a readily ascertainable quantity produced by a simple mathematical calculation. Therefore section 2.306 did not apply. The court agreed with Tennessee that there was an applicable good faith standard, but not the one found in Texas UCC section 2.306. The applicable standard is found in section 1.203 as defined in sections 1.201(19) (honesty in fact) and section 2.103(a)(2) (observance of reasonable commercial standards of fair dealing in the trade). “The [Texas] UCC limits Tennessee’s take-or-pay obligations to good faith increases in delivery capacity.”

Transamerican Natural Gas Corp. v. Finkelstein addressed the right of an overriding royalty owner to share in repudiation damages for repudiation of a take-or-pay gas contract as to that portion of the gas actually produced and sold in the spot market. When El Paso Natural Gas farmed out the La Perla Ranch to Transamerican’s predecessor in 1975, Finkelstein earned an overriding royalty on the property. El Paso retained a

117. Id. at 569 (citing Tex Bus. & Com. Code Ann. § 2.306 (Tex. UCC) (Vernon 1994)).
118. Id. at 569-70.
119. Id.
121. Id. § 2.306(a).
122. Lenape, 925 S.W.2d at 570-73.
123. Id. at 571.
124. 933 S.W.2d 591 (Tex. App.—San Antonio 1996, writ requested).
preferential right to purchase the gas under the terms of the farmout, which it exercised in 1981 by entering into a long term take-or-pay contract with Transamerica's predecessor and which also included Finkelstein's gas.125

El Paso's attempts to avoid the take-or-pay contract resulted in litigation and a judgment against El Paso in favor of Transamerica for take-or-pay damages in excess of sixty million dollars and repudiation damages in excess of four hundred million dollars. The jury findings on damages corresponded exactly to Transamerica's experts' testimony as to the present value of the difference between El Paso's required price under the contract and the February, 1987 (date of repudiation) spot market price for the gas. El Paso then settled by conveying its La Perla Ranch minerals and cash to El Paso, and by canceling the 1975 farmout and the 1981 gas contract, thereby settling all claims of Transamerica and its "assigns." This resulted in a washout of Finkelstein's interest in La Perla Ranch minerals.126

When Transamerica refused to pay Finkelstein any part of the settlement, Finkelstein sued. Because Killam Oil Co. v. Bruni127 made it clear that Finkelstein had no hope of sharing in settlement proceeds attributable to take-or-pay settlement payments, Finkelstein sought to recover a share of the repudiation damages allocable to the overriding royalty on gas produced and attributable to his interest prior to the washout. He obtained favorable jury findings on breach of the duty to reasonably market and unjust enrichment by contending that Transamerica had essentially been paid twice for the gas. Transamerica had sold the gas on the spot market to mitigate its losses, for which it paid Finkelstein his overriding royalty. Transamerica also had received repudiation damages attributable to the produced gas, for which it paid Finkelstein nothing.128

In the panel opinion (attached as an Appendix to the opinion as a dissent), the court accepted Finkelstein's argument that repudiation damages and take-or-pay damages were distinct, and because Bruni left open the question of a royalty owner's right to share in "nonrecoupable" payments, Bruni was inapplicable.129 Because the gas had actually been produced, Finkelstein was permitted a recovery. In its opinion on Motion for Rehearing En Banc, the court reversed and rendered, because a royalty owner is not entitled to settlement proceeds from a take-or-pay contract, absent lease language to that effect, whether or not gas is sold to third parties on the spot market.130

The court reasoned that its opinion in Bruni was fundamentally based on the idea that royalty is usually only payable for gas actually extracted

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125. Id. at 594.
126. Id.
128. Finkelstein, 933 S.W.2d at 594-95.
129. Id. at 599.
130. Id. at 593.
from the land, and that this view had recently been confirmed by the Texas Supreme Court when it described a take-or-pay payment as compensation "for the exclusive dedication of reserves for a fixed period of time." In other words, take-or-pay payments are made for gas not produced, and thus bear no royalty.

The court concluded that Finkelstein's overriding royalty was also payable on gas actually produced. Awards as damages for nonpayment of take-or-pay payments or for repudiation both represent payments for nonproduction. The court held that Lenape resolves the issue of whether the non-recoupable take-or-pay payment is compensation for past and/or future gas production or for storing the gas through its explanation that take-or-pay payments represent compensation for the exclusive dedication of reserves for a fixed period of time. Take-or-pay is not a benefit which flows from the marketing covenant of the lease, which only requires that Finkelstein be paid for the gas produced and sold on the spot market. The court summarily dismissed Finkelstein's unjust enrichment argument as not available when the same subject is covered by an express contract.

The original opinion in Enserch Corp. v. Rebich was withdrawn by the court, and a new opinion was issued on Motion for Rehearing. In that case, the applicable gas contract was executed in 1980 for a term of fifteen years and called for pricing to be tied "to the maximum lawful price for Section 102 ... gas," as determined by the federal government under the Natural Gas Policy Act of 1978 (NGPA). The Section 102 gas price was calculated monthly by the Federal Energy Regulatory Commission using a formula that resulted in a progressively escalating price that has significantly exceeded the market price for gas. When the gas market collapsed, Enserch unilaterally began paying at a market rate in 1984. For the next 100 months Rebich and his predecessors simply accepted the lower prices. In 1985 gas prices on domestic wells were deregulated, so that there was no longer a "maximum lawful price." Deregulation, however, did not end the publication of a Section 102 price, although the price published after deregulation pertained to the type of Section 102 gas produced offshore. In January of 1993 the NGPA was repealed, and the government ceased publishing the Section 102 price altogether.

131. Id. at 597.
132. Id. (citing Lenape Resources Corp., 925 S.W.2d at 570).
133. Id. at 598.
134. Id. at 599.
135. Id. at 598.
136. Id. at 600.
137. Id.
139. 925 S.W.2d 75 (Tex. App.—Tyler 1996, writ dism’d by agr.).
140. Id. at 78.
Rebich filed suit in April of 1993 to recover the underpayment for gas for the four years preceding the date that his suit was filed. The trial court granted summary judgement for Rebich, and the judgment also fixed the price from March of 1993 (when the Section 103 price ceased to be published) until the expiration of the contract in 1995 at the last published Section 102 price. The Tyler Court initially affirmed, but on rehearing remanded on the issue of modification. The interesting issue in the case was Enserch's argument that “maximum lawful price” was the controlling phrase, which the court conceded had no meaning after 1985. Nevertheless, the remainder of the contract terminology, “for Section 102 . . . gas” remained. The court concluded that the parties selected this index for their pricing scheme, and it provided a certain and definite meaning.\textsuperscript{141}

Enserch argued that there were other possible interpretations rendering the contract ambiguous, or at least not subject to summary judgment. In particular, Enserch contended that the contract was silent as to a post-deregulation price, and therefore upon deregulation a commercially reasonable price or the last regulated price should control. The court rejected this argument because the parties knew in 1980 when they entered into the contract that gas prices would be deregulated in 1985, and therefore there would be no “maximum lawful price” thereafter. It was not reasonable to interpret the contract as having no pricing provision applicable to the final two-thirds of the contract period.\textsuperscript{142}

None of Rebich's predecessors expressly consented to the lower prices, but none objected, and they each negotiated their checks without a reservation of rights.\textsuperscript{143} Enserch raised affirmative defenses of waiver, estoppel, novation, ratification, amendment and modification. Modification, ratification, amendment and novation were each initially rejected, because any revision of the contract was required to have been in writing and signed.\textsuperscript{144} On rehearing the court was forced to consider each of these issues in detail because the statute of frauds was not pled by Rebich. Waiver, estoppel, novation and ratification were quickly rejected, but amendment and modification raised a fact issue requiring that the case be remanded.\textsuperscript{145} Specifically, the court concluded that the acquiescence and acceptance without objection of the reduced prices raised a fact issue as to whether the price modifications were impliedly accepted by Rebich's predecessors.\textsuperscript{146}

The significance of the case is that there may still be a number of these old “maximum lawful price” contracts still in effect, and under which producers have taken an inert position similar to the facts in this case. The opinion suggests that for these producers, assuming they plead the statute

\textsuperscript{141} Id. at 80.
\textsuperscript{142} Id. at 81.
\textsuperscript{143} Id.
\textsuperscript{145} Enserch Corp., 925 S.W.2d at 81-84.
\textsuperscript{146} Id. at 84.
of frauds, there may be an avenue of recovery still open against their purchaser.

VIII. REGULATION

_Railroad Commission of Texas v. Torch Operating Co._ holds that the Commission had the statutory authority to exempt a subsequent operator from temporary field rules based on lack of notice and that the evidence was sufficient to support a finding that the subsequent operator should be exempted from the temporary field rules.

Kilroy drilled the discovery well and a development well in the Bammel, North (6,100' Cockfield) Field. Kilroy applied for temporary field rules to change the spacing and density requirements from forty-acre proration units under statewide rules to six hundred forty-acre proration units. Goodrich also held operating rights under leases in the Bammel Field. Goodrich applied for a drilling permit under statewide rules, before any temporary rules were established for the Bammel Field. Temporary field rules were then adopted, but ten days later the Commission issued Goodrich a permit on the basis of statewide rules. The Commission even later allowed Goodrich to amend its application again under statewide rules. However, when Goodrich finally completed drilling its well, the Commission refused to issue an allowable to the well because it was not drilled in accordance with the applicable temporary field rules.

Torch succeeded Kilroy and complained that Goodrich was producing without an assigned allowable. The Goodrich well was shut in, and the Commission convened a contested case to review the period during which the temporary field rules were in effect.

Statewide Rule 43 requires that an applicant for a temporary field rule provide the agency with a list of the names and addresses of all operators holding leases on land touching the tract on which the discovery well is located. Goodrich held leased acreage abutting the pooled unit for Kilroy's discovery well, although Goodrich's lease did not touch the proration unit assigned to the discovery well. Kilroy did not provide Goodrich's name to the Commission, and Goodrich was not notified of the hearing. Kilroy had actual knowledge of Goodrich's competitive position in the Bammel Field and knew that Goodrich would be affected by the proposed temporary field rules.

The court noted that due process attaches to the property rights that arise from a mineral estate and that the Commission is required by statute to ensure that no rule or order is adopted by the agency except after

147. 912 S.W.2d 790 (Tex. 1995).
148. Id. at 790-91.
149. Id. at 791.
150. Id.
152. Torch Operating Co., 912 S.W.2d at 792.
adequate notice and a hearing have been provided. Therefore the Commission could decide that Goodrich was not bound by the temporary field rules and was entitled to makeup the production lost during the period the well was shut-in.