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OIL AND GAS

SCOPE OF JUDICIAL REVIEW OF RAILROAD COMMISSION ORDERS

Two cases were decided in 1947 which bear upon the elusive "substantial evidence rule." This rule is the principle of administrative law which is said to define and limit the scope within which the courts may review rules and orders made by the Railroad Commission in regulating the oil and gas industry.

These Civil Appeals decisions were both affirmed by the Supreme Court in 1948, each case resulting in the cancellation of a permit to drill an oil well as an exception to Rule 37. Only the Supreme Court’s opinions will be considered here. Their effect cannot be appreciated without a preliminary examination of the rule as it previously existed.

Section 8 of Article 6049c provides that interested persons aggrieved by orders or regulations of the Commission

"...shall have a right to file a suit in a court of competent jurisdiction in Travis County...to test the validity of said laws, rules, regulations, or orders. Such suit shall be advanced for trial. In all such trials, the burden of proof shall be upon the party complaining...and such law, rule, regulation or order...shall be deemed prima facie valid." (Italics supplied.)

In 1939 the Supreme Court first stated what is now known as the substantial evidence rule, in Gulf Land Co. v. Atlantic Refining Co.: orders of the Commission should not be upset unless illegal, unreasonable, or arbitrary and an order does not
possess such character if it is "...reasonably supported by substantial evidence." This phraseology has been repeated by all the cases, but the court made other statements which have not been so followed: that the Commission should have power to "...finally determine controverted issues of fact..."; that although orders of the Commission might be supported on legal grounds not recited by the agency as a basis for the order, this did not mean that the district court could determine material controverted fact questions not passed upon by the Commission. Such a holding, it was asserted, would violate the "rule" that the Commission finally determines all fact issues and destroy uniformity of Commission administration. In this case the issue was confiscation and the facts were undisputed. The permit was cancelled, the court holding, as a matter of law, that it was not supported by substantial evidence.

In 1942 the opinion in the Trem Carr case was delivered by the late Chief Justice Alexander, cancelling a permit which had been granted as an exception to prevent waste. The Commission contended that it should take testimony and make fact findings which should be accepted without an independent hearing of the evidence and be binding upon the courts if supported by any substantial evidence in the record. The Chief Justice said that the question had been previously settled to the contrary in Magnolia Petroleum Co. v. New Process Co. and the Century case. He stated that the doctrine that administrative findings should be conclusive if supported by substantial evidence originated in express federal statutes, was foreign to Texas law, had never been sanctioned by the Texas legislature, and he strongly intimated that such a statute would contravene the Texas Constitution. He then examined Article 6049c, Section 8, saying that the word "trial" therein connotes a judicial examination of the

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7 129 Tex. 617, 104 S. W. (2d) 1106 (1937).
evidence; that there would be no necessity for placing the “burden of proof” if it had not been intended that proof be heard, and concluded that the statute clearly contemplates that the evidence be heard de novo in the district court. Otherwise the Commission might reject material evidence or admit that which is inadmissible. The Chief Justice pointed out the enormous power which the Commission would have if it could bind the courts in such a manner and the dangerous consequences thereof. He then repeated the rule: that the courts will not disturb a Commission order which is reasonably supported by substantial evidence, but he added that the issue is not whether the agency came to the proper fact conclusion but

... whether or not it acted arbitrarily and without regard to the facts. ... This does not mean that a mere scintilla of evidence will suffice, nor ... that the court is bound to select the testimony of one side with absolute blindness to the other. After all, the court is to render justice in the case. The record is to be considered as a whole, and it is for the court to determine what constitutes substantial evidence.... If the evidence is such that reasonable minds could not have reached the conclusion that the agency must have reached in order to justify its action, then the order must be set aside.”

The Trem Carr case construes Gulf v. Atlantic to mean that there must be a new and independent trial in court wherein all evidence introduced at the trial and the credibility of the witnesses should be considered in determining whether the Commission’s order is supported by substantial evidence. This was not made clear in Gulf v. Atlantic. The Trem Carr case does not say that there should be a jury trial, or even a decision by the court based upon a preponderance of the evidence. It says that the permit should be upheld if reasonably supported by substantial evidence upon the record as a whole. The evidence must be such that, in an ordinary jury trial, a directed verdict would not be proper.

In 1944 Chief Justice Alexander again delivered a unanimous
decision in *Marrs v. Railroad Commission,* where *confiscation* was involved. In holding the proration order there attacked to be a violation of due process the court said:

"It is clear... that it (the legislature)... intended that there should be a 'trial' of the issues in court, and no limitation is placed upon the sort of trial to be had, except that it must be one to test the validity of the order, and the burden of proof is upon the one complaining thereof. A 'trial' as commonly understood contemplates a judicial examination of all the issues of law and fact. There cannot be a judicial examination without the right to pass upon the credibility of the witnesses and the weight to be given to the evidence.

"... this suit was brought both as a statutory suit under Art. 6049c, Section 8, to test the validity of... proration orders and as a bill in equity to restrain the Commission from restricting production... in such a manner as to constitute taking of the plaintiff's property without due process of law.

"... upon the trial... the court had the right to hear the evidence. In passing on such issues the court had the right to pass on the credibility of the witnesses and the weight to be given to the evidence.

"... in suits brought to set aside an order, rule, or regulation on the ground that it violates one's constitutional rights... the law contemplates an independent review of the facts by the court as in other civil actions...

"This is not a case of mere waste in which the Commission has exercised the sound discretion invested in it to conserve our natural resources... the orders here complained of have the effect of taking one's property under circumstances where the evidence shows that this is not necessary in order to conserve natural resources.

"The record... contains evidence legally sufficient to show confiscation of property... in such a case our Constitution guarantees a trial of such issues as in other civil cases.

"In making this ruling we in no wise question or overrule anything said by the court in either... (Railroad Commission v. Shell Oil Co. or Gulf Land Co. v. Atlantic Refining Co.)."

This seems to both broaden and approve the rule of the *Trem Carr* case. In the trial *de novo* the court should, under this case, place its own values upon the testimony. Apparently the court did not consider the *Trem Carr* and *Gulf-Atlantic* cases as conflicting, since it gives inferential approval to both.

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10 142 Tex. 293, 177 S. W. (2d) 941 (1944).
Note the emphasis in the Marrs case on the proposition that in cases involving constitutional rights there is a necessity for full judicial review, and the reference to the fact that the suit in question was also a bill in equity and not merely a statutory action under Article 6049c.

In 1946 Thomas v. Stanolind Oil Co.¹¹ and Trapp v. Shell Oil Co.¹² were decided on the same day. In both permits had been granted as exceptions to prevent waste and confiscation, but the facts show that in each case the principal issue was whether the permittee was at a drainage disadvantage and being deprived of the opportunity to recover his fair share of the oil beneath his tract; therefore the problem involved was confiscation.¹³ In each case the trial court had cancelled the permit and the Court of Civil Appeals had affirmed. In both instances the Supreme Court reversed the lower courts and rendered judgment upholding the permits. In each Chief Justice Alexander dissented. In the Thomas case his dissent is upon the ground that the judgment of the trial court was "... undoubtedly in accordance with the overwhelming weight of the evidence," and the reader is referred by the Chief Justice to his dissent in the Trapp case for his reasoning. In the majority opinion in that case the court begins by quoting extensively from the Gulf-Atlantic, Trem Carr, and Marrs cases and it recognizes the difference between the rules as expressed by the first and the latter two. It then makes the statement that the "... rules announced in the Gulf-Atlantic case are now the prevailing rules... notwithstanding the conflicting statements in the Trem Carr and Marrs cases." The court recognized that much of what was said in the Gulf case was dictum, and answered that the same is true of the Trem Carr case, but that the statement in the Marrs case that the two earlier decisions were not thereby overruled cannot be

¹³ Gulf Land Co. v. Atlantic Refining Co., 134 Tex. 54, 131 S. W. (2d) 73.
classed as dictum. Then, after expressly approving the Gulf-
Atlantic case, the court says that the district court

"... was not required to close its eyes to fraud or sham. The sub-
stantial evidence rule does not mean that the parties are limited to the
evidence taken by and before the Railroad Commission. The parties
may ... introduce any relevant legal testimony in the district court. ... The trial court does not have to consider incredible, perjured, or unreas-
sonable testimony because such evidence is not substantial.

"We shall not attempt to formulate a comprehensive definition of the
rule, but it is believed that the court made a fair statement of the rule
in the Trem Carr case...." [14] (Italics supplied.)

Chief Justice Alexander, in his dissent, interprets the majority
opinion as binding the courts if there is any substantial evi-
dence, and as preventing them from passing upon the credibility
or weight to be given testimony in determining whether it is sub-
stantial. He admits that the Commission may be given discretion
to determine how waste shall be prevented, if it is first shown
that oil is being wasted, but, in his view, the fallacy of the major-
ity is in their failure to distinguish this from the right of the
courts to determine whether the order amounts to confiscation.
Among other cases, he cites Crowell v. Benson, [16] Ohio Valley
right is involved

"... the owner (is) entitled to a fair opportunity for submitting that
issue to a judicial tribunal for determination upon its own independent
judgment as to both law and facts." [18]

In Hawkins v. The Texas Co. and Wrather v. Humble, decided
four months later, the Supreme Court affirmed decisions of the
Court of Civil Appeals which had upheld trial court decrees

cancelling permits granted as exceptions to prevent waste. There was considerable testimony in each case which, at first blush, appears conflicting, but in each case the court convincingly construes that testimony as merely an argument in favor of the "more wells, more oil" theory, which was discredited in the Trem Carr case. It follows the holding of that case, that this argument is not substantial evidence to support a waste exception, and that, since there was no showing of unusual local conditions the permits could not be valid. This is the extent of the Supreme Court's discussion of the substantial evidence rule in Wrather v. Humble, but in the Hawkins case the court discerns a misconception of the meaning of "substantial evidence" in the permittee's brief and undertakes to correct this error.

Hawkins, quoting from the dissenting opinion of the late Chief Justice in the Trapp case, contended that under the majority opinion in that case, as soon as one witness testified to facts which would support the permit the court would be powerless to upset it. The Supreme Court said:

"The substantial evidence rule does not mean that...
"...the finding of the Commission will be sustained...if it is reasonably supported by substantial evidence, meaning evidence introduced in court. The word 'reasonably' has been deliberately used in the statement and its use gives to judicial review a broader scope than it would have if some substantial evidence were regarded as sufficient of itself to sustain the Commission's order. It is for the court to determine as a matter of law the reasonableness of the support afforded by substantial evidence...(citing the Thomas and Trapp cases).

"...the court examines and takes into consideration all of the evidence, the entire record. (citing Trapp v. Shell Oil Co.)...the court makes its own findings based upon a preponderance of the evidence before it. Nevertheless, it means that there shall be a trial and in that trial the court determines from all the evidence before it, the entire record, whether the Commission's action is or is not reasonably supported by substantial evidence. The foregoing is a reiteration of the
... rule made in Railroad Commission v. Shell Oil Co., the Trem Carr case, which was quoted with approval in the Trapp case....”

This, then, is the present state of the law: on appeal from orders of the Railroad Commission evidence is heard anew in the district court. The court weighs this evidence and determines whether the order is substantially supported thereby, so as not to be arbitrary, unreasonable, or illegal. A jury trial is not available to the litigant, but the scope of appellate review is broader than in ordinary civil suits. Both the Court of Civil Appeals and the Supreme Court may examine the entire record, de novo, without regard to holdings of inferior courts, and determine whether substantial evidence existed to reasonably support the Commission’s order, since this is a matter of law.

It may still be possible to obtain an ordinary trial in the district court, with a jury, by filing an independent bill in equity and alleging that property is being taken without due process of law. The Trapp, Thomas, and Hawkins cases dealt only with statutory review. In Marrs v. Railroad Commission the court seemed to recognize that where an action is brought in equity due process requires more than the statutory review, and this part of that case has never been overruled. If confiscation is specifically raised in a suit in equity, the Ben Avon Borough case and numerous other decisions of the United States Supreme Court will also support the position that an ordinary trial de novo as to both law and fact is a matter of right.

20. The Supreme Court’s jurisdiction on appeal is limited to questions of law. Therefore it may not consider the entire record in ordinary civil suits, and the Courts of Civil Appeals are generally bound by findings of the trial court as to questions of fact unless such findings are manifestly against the weight of evidence.
21. These cases are still followed, but have been slightly modified. In St. Joseph Stockyards v. U. S., 298 U. S. 38 (1935), the Supreme Court said that where the issue is confiscation a court is not bound to accept administrative findings even though they are supported by substantial evidence, but that the burden is upon the person complaining of the administrative action to make a convincing showing, and that a court will not interfere with the order attacked unless confiscation is clearly established.
SCOPE OF RAILROAD COMMISSION'S AUTHORITY TO PREVENT WASTEFUL FLARING OF CASINGHEAD GAS

In *Railroad Commission v. Shell Oil Co.*[^22] the Railroad Commission issued an order prohibiting the flaring of gas and directing producers in the Seeligson Field to shut down their oil wells unless and until the gas, produced as an incident to the recovery of oil, was put to one of the following beneficial uses: (1) light or fuel; (2) efficient manufacture of chemicals other than carbon black; (3) repressuring; (4) extraction therefrom of natural gasoline and re-injection of the dry gas residue. The producers attacked the order on the ground that the Commission lacked statutory authority to promulgate such a regulation. The Supreme Court, on direct appeal,[^23] upheld the district court's grant of a temporary injunction pending final determination of the cause. Articles 6014, 6015, and 6029[^24] were construed as conferring power upon the Commission to make and enforce all regulations reasonably necessary to prevent waste. The court stated that the validity of the order, as distinguished from the Commission's authority to make it, depended upon whether, upon a full development of the facts, it was reasonably supported by substantial evidence and, when so tested, appeared reasonable and just and its enforcement feasible and practicable.

Article 6014 condemns waste generally as being unlawful, and specifically includes certain things as constituting waste.

One of the wasteful practices therein enumerated is the operation of any well with an inefficient gas-oil ratio. The producers urged that, since the Commission had fixed a ratio for the field, with which they had complied, the burning of gas within that


[^23]: Tex. Rev. Civ. Stat. Ann. (Vernon's 1925) art. 1738a and Rule 499-a, Tex. Rules Civ. Pro., provide for direct appeal to the Supreme Court from any order of any trial court granting or denying an injunction wherein the constitutionality of a statute or the validity of an administrative order, issued under any Texas statute, is involved.

ratio could not be wasteful. The court thought it possible for the practice to be wasteful in certain circumstances. Article 6015 is a broad proscription of waste. Article 6029 authorizes the Commission to issue regulations to prevent waste:

“(8) It (The Commission) shall do all things necessary for the conservation of... oil and... gas and to prevent the waste thereof, and shall make and enforce such rules, regulations or orders as may be necessary to that end.”

In the opinion of the court these provisions give authority to, and impose a responsibility upon the Commission to prescribe fair and reasonable rules whenever a preventable waste exists or is imminent, and the types of waste “specifically included” in Article 6014 are only illustrative, not the limits, of the authority delegated to the Commission by the Legislature. If beneficial uses were reasonably available and gas were being wastefully burned, then an order such as this would be valid. If conditions were such that it would not be reasonably practicable to use the gas in the manner proscribed, then, the Court said, the order would not be valid, since the legislative standard would have been violated.

This order marks the first instance in which the Commission has undertaken to completely shut down oil wells to prevent waste of natural gas. However, the construction here given to the conservation statutes is not new. Article 6029 has been broadly construed. Neither its specific provisions nor those of Article 6014 are exclusive definitions of waste, or limits upon the types of orders which the Railroad Commission may issue. Article 6008 relates to the conservation of gas alone, but it is substantially similar in wording to Article 6029. In a case aris-

ing thereunder it was said of the conservation laws generally that, although they are often specific, they are designed to prevent all waste, whether specifically defined or not. The decision in Railroad Commission v. Shell Oil Co. is consonant with these holdings and adheres to the manifest import of the statutes concerned.

**ADVERSE POSSESSION OF MINERALS CONTINUED BY ONE OUT OF POSSESSION THROUGH HIS GRANTEE OF THE SURFACE**

In *McLendon v. Comer*, grantor, in adverse possession of the entire fee, both minerals and surface, purported to sever and convey the surface before title matured under the ten-year statute. Grantee entered and completed the ten-year period. The court held that the continued use and claim to the surface by the grantee inured to the benefit of the grantor in maturing title by limitation to the mineral estate, since grantee and grantor were in privity of estate and had a unity of interest as against the disseized owner.

There is, apparently, no precedent on all fours with this case, but it is aligned with both the general Texas law of limitations and that relating peculiarly to minerals.

Adverse possession of land may be acquired by one out of possession through a tenant or an agent. A trespasser may satisfy statutory requirements of length of possession by "tackling" the adverse holdings of prior successive trespassers with whom he is connected by privity of estate. A vendor may assert limitation by virtue of possession held by his purchaser. Where there has been no severance before entrance of the trespasser,

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33 Morris v. Meek, 57 Tex. 385 (1882); 2 Tex. Jur. 77, Sec. 40 (1931).
adverse possession matures limitation title to both surface and minerals, and severance by the true owner does not interrupt the running of the statute as to either surface or minerals. Where the true owner severs the minerals and remains in possession of the surface, his continued possession is not adverse to the mineral estate retained by his grantor, in the absence of drilling by the former.

Clements v. Texas Company is the basis for many holdings on mineral limitations. It was there said that:

"... a severance by one in possession, who has not yet matured a title, does not abandon, limit, or qualify his possession for the purpose of ripening a title against the true owner out of possession, and that, as against such disseized owner, the continued possession of a trespasser after severance, as before, is adverse, and that such possession continued by either the trespasser or the third person to whom he severs will mature a title by limitation to the entire tract as against such disseized owner."

In the Clements case the trespasser severed and purported to convey the mineral leasehold interest. However, its language is broad and seems to wholly support the principal case, wherein precisely the converse fact situation existed. Analogy to the law of vendor-purchaser, stated above, also seems in point, and it is not too far fetched to compare the purported grantee here to an agent or tenant, for the purposes of this case.

The holding is sound. It was to be expected, and helps to round out the incomplete series of Texas decisions relating to adverse possession of mineral interests.

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Id. at 1005.
In Bennett v. Scofield a decedent's executors sought the refund of an alleged overpayment of a federal income tax assessment. In 1934 decedent executed a five-year oil and gas lease upon his separate land, under the terms of which the lessee was given an option of retaining part of the acreage for an additional period of fifteen years by making one lump sum payment. In 1939 the lessee exercised the option, but the parties agreed that payment should be made in ten annual installments rather than one lump sum. The executors contended that the annual payments were delay rentals, constituting community property of decedent and his surviving spouse, and that, therefore, only one-half their value was taxable. It was held that the unpaid installments were "advance royalty," or "bonus," and separate property. Upon decedent's death their full value could be included as a part of his gross estate.

"Bonus" is a sum paid or contracted to be paid, in addition to royalty, as a part of the purchase price of a lease and represents a part of the market value thereof. The sale of an oil and gas lease is a sale of a part of the land. Therefore, if the land is separate property, the proceeds of the sale are, under the principle of mutations, separate property of the owner of the land. "Delay rentals" are rents which accrue by the mere lapse of time and, like other rents, are income. The income derived from separate property belongs to the community estate. Although royalty and bonus are treated as "income" for income

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42 3 Summers, Oil and Gas 346-347 (Perm. ed. 1938).
43 Stephens County v. Mid-Kansas Oil & Gas Co., 113 Tex. 160, 254 S. W. 290 (1923); Texas Co. v. Daugherty, 107 Tex. 226, 176 S. W. 717 (1915).
44 Commissioner of Internal Revenue v. Wilson, 76 F. (2d) 766 (C. C. A. 5th 1935).
tax purposes,\textsuperscript{46} where the question is not their taxability, but their ownership, state law controls.\textsuperscript{47}

A part of the usual lease is a provision for a primary or exploratory term which, in the absence of production, determines the life of the estate.\textsuperscript{48} Delay rentals are paid for the privilege of delaying development during that term.\textsuperscript{49} Since production had not been attained, the lease in \textit{Bennett v. Scofield} would have terminated by its own terms in 1939 if the option had not been exercised by the lessee. The life of the lease was thereby extended. No payments were to accrue during this new life merely by virtue of the passage of time in order to delay development. The payments were to be made for the same purposes that the original purchase price of the lease was paid. Hence, from oil and gas standpoint, their classification as bonus seems proper, irrespective of the principles of federal taxation.

\textbf{Ambiguity in Mineral Deeds—Late Payment of Delay Rentals Excused}

In \textit{Humble Oil \\& Refining Co. v. Harrison}\textsuperscript{50} the grantors, owning an undivided three-fourths mineral interest in land, conveyed to the defendant one-half of all the minerals (which would amount to two-thirds of their three-fourths) subject to two existing "unless" type oil and gas leases which were owned by the plaintiff, Humble. Covenants in these prior leases provided that no change in ownership should impose any additional burden upon the lessee. Humble construed the conveyance so as to pay the depository bank, for credit to the grantee, only one-half of the rentals due on three-fourths of the minerals. The bank mailed

\textsuperscript{46} Burnet v. Harmel, 287 U. S. 103 (1932); Commissioner of Internal Revenue v. Wilson, 76 F. (2d) 766 (C. C. A. 5th 1935).

\textsuperscript{47} Commissioner of Internal Revenue v. Wilson, \textit{Ibid.}

\textsuperscript{48} \textit{Oil and Gas} 31-A \textit{Tex. Jur.} 283 (1947).


\textsuperscript{50} \textit{Tex. ...}, 205 S. W. (2d) 355 (1947).
deposit slips to the defendant which were received well before the due dates. The defendant remained silent, making no request for additional payment, but one month after the due date under one lease, four months after due date under the other, he gave notice that he considered the payments insufficient, the leases terminated, and of his refusal to accept the tenders. On the next semi-annual rental date Humble deposited to the defendant’s credit the same proportional amount and offered to make what it considered an overpayment to satisfy his contentions. The defendant refused to accept any payment whatsoever and demanded a release. Humble refused and brought suit to remove a cloud from and quiet its title. The court held that where a lessee has, in good faith, made payment in accordance with a misconstruction of an ambiguous conveyance and the transferee has notice of the mistake, the latter has a duty to notify the lessee of the error. Failure to speak estopped the defendant from declaring the lease terminated.

Upon failure of a lessee to either commence drilling or pay the full amount of delay rentals promptly upon the due date an “unless” type lease ipso facto terminates. If a lessee, under a divisible lease, fails to properly apportion and pay one of the owners the lease terminates as to such owner, and in an “unless” type lease notice of termination is not required, since the estate terminates automatically by reason of limitations in the grant. However, the rules of estoppel may be invoked in respect to rights and obligations arising out of such instruments. Acceptance of tardy payment of delay rentals has been held to pre-

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52 Walker, The Nature of Property Interests Created By An Oil and Gas Lease in Texas, 8 Tex. L. Rev. 483, 529 (1930).
clude a lessor from asserting that the lease terminated, but failure to make prompt payment is not excused merely because the failure was unintentional, or for other reasons not amounting to estoppel.

Generally, the courts have been strict in compelling prompt payment. Thus, in Empire Gas & Fuel Co. v. Saunders the Fifth Circuit Court of Appeals held that the lessor had no duty to inform the lessee of its mistake even though the defective tender was made one month in advance. In Coker v. Benjamin a Texas court reached a similar result. These cases are distinguishable from the Harrison case since the conveyance in both were not ambiguous.

The Supreme Court, in the principal case, cited those cases as examples of the strict construction of the rule that an "unless" lease terminates immediately and irrevocably upon a failure to comply with its limitations. The court stated, however, that the rule has been relaxed in some instances. Mr. Justice Hart reasoned that the failure to pay the defendant his full share resulted from (1) Humble's misconstruction of the grantor's ambiguous instrument and (2) defendant's failure to notify Humble of the proper construction. He felt that it would, contrary to the terms of the leases, impose an additional burden upon the lessee to require it to determine, at its peril, the proper construction of an instrument to which it was not a party.

While the Saunders case and Coker v. Benjamin are definitely

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57 22 F. (2d) 733 (C. C. A. 5th 1927), certiorari dismissed 278 U. S. 581, 49 S. Ct. 184 (1929).


not overruled, the language of *Humble v. Harrison* may furnish a possible basis for further relaxation of the existing rule in the future. Although, technically, "unless" leases terminate by their own limitations, the practical result is harsh and closely akin to forfeiture. It is submitted that a lessor who has actual knowledge of a deficient rental payment, seasonably made through an innocent mistake, has a duty to speak and that failure to do so should estop him from asserting termination of the lease even though the instrument of transfer is ambiguous, provided that the lessee offers to correct the mistake upon learning thereof.

**CONSTRUCTION OF LEASE COVENANTS—LATE PAYMENT OF DELAY RENTALS**

In *Benson v. Lacy*60 a lease covenant provided that no change in ownership of the land should increase the obligations or diminish the rights of the lessee, notwithstanding actual or constructive notice to him, or be binding upon him unless or until thirty days after (1) written notice to lessee from both the lessor and the lessor's successors, and (2) delivery to the record owner of the lease of certified copies of the recorded instruments of transfer. All covenants were declared binding upon the heirs, successors, and assigns of the parties. The lessor conveyed a one-half undivided mineral interest, subject to the lease, to the plaintiff. The latter delivered copies of the recorded assignment to the defendant lessee, but no written notice was given by either the plaintiff or the lessor. The defendant paid all delay rentals to the original lessor and the plaintiff sought cancellation of the lease as to his interest. The court held that since all requirements of the lease were not met, the assignor was not entitled to cancellation. Parties may contract in any manner agreeable to them which does not violate the law or contravene public policy. The additional requirement of notice was not, as contended by the plaintiff, unreasonable and void as against pub-

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lic policy. Business and prudence dictated that the parties insert such provisions for their mutual protection. Since the plaintiff had taken subject to the lease he had assumed the obligations thereof and was fully bound by its terms.

The decisions show that covenants requiring delivery of copies of transfer instruments to a lessee are valid conditions precedent and that if such a covenant is not met the lessee will not be bound by the transfer.\textsuperscript{61} Literal compliance with provisions for written notice has also been required.\textsuperscript{62} Delivery of a lessor's recorded deed does not meet a requirement of written notice to the lessee from both the lessor and his assignee,\textsuperscript{63} and provisions requiring actual notice are not violative of any law or the public policy of this state,\textsuperscript{64} since registration statutes do not deprive parties of the right to contract expressly for the waiver of their protection.\textsuperscript{65}

\textbf{AMBIGUITY IN LEASE ASSIGNMENTS}

In \textit{Sanford v. Farmer}\textsuperscript{66} the defendant conveyed unto plaintiff two fractional interests of the oil and gas in a 7/17 acre tract. At the time of the assignment there was only one well on the tract but, subsequently, a second was brought in. The assignment recited that it conveyed:

\begin{quote}
"... all rights, title and interest... in an undivided one-sixteenth (1/16) of seven-eighths (7/8) working interest, in and to Well No. One... and... an undivided one-thirty-second (1/32) of seven-eighths (7/8) reversionary working interest, same being a part of one-eighth (1/8) of seven-eighths (7/8) retained by lessors in the... lease until...
\end{quote}


\textsuperscript{62} Gulf Refining Co. v. Shatford, 159 F. (2d) 231 (C. C. A. 5th 1947).

\textsuperscript{63} Gulf Refining Co. v. Shatford, 159 F. (2d) 231 (C. C. A. 5th 1947).

\textsuperscript{64} Ibid.


lessors... receive Ten Thousand Dollars from the sale of one-eighth of seven-eighths of the oil... from said well... said... interest... to become effective when the remaining unpaid portion of said Ten Thousand Dollar oil payment shall have been paid..." (Italics supplied.)

The interest retained by the lessors ran throughout the entire tract, but defendants contended that the 1/32 interest conveyed to plaintiff was limited to Well No. One, as plaintiff admitted the 1/16 interest to be. The court held that the instrument conveyed a 1/32 interest running through the entire tract. The phrase "from said well" referred only to the date on which plaintiff's interest was to take effect, and two separate estates in the same land were conveyed.

The primary object in construing a deed is to ascertain the intention of the parties, and where the language of a grant is ambiguous artificial rules of construction are applied by the court to ascertain, from the language, the apparent intention. One of these rules is that, since the language of a deed is that of the grantor, in doubtful cases it will be construed against him and in favor of the grantee. Also, where an instrument is ambiguous the court will, if possible, harmonize the parts and construe it so that all of them may stand. When all the parts are harmonized the instrument will be construed to convey the greatest estate that the terms of the instrument will permit.

These propositions are well settled. In Sanford v. Farmer the court based its holding upon the latter two, citing Cartwright v. Trueblood. The case adds nothing to the substantive law, but is noteworthy as an authoritative holding upon an unusual fact situation.

67 Id. at 997.
72 Note 69, supra.
In Sanders v. MacDonald, Sanders conveyed to MacDonald, warranting title, the entire seven-eighths leasehold interest to certain land. Later Sanders discovered that he owned only six-sevenths of the minerals under the tract. He and Stewart agreed to purchase the remaining one-seventh interest jointly. It was contemplated that Sanders acquired one-eighth of one-seventh in order to give him a full one-eighth interest in the tract, and Stewart was to own the remainder. Sanders was to procure a deed made out to Stewart and draw a draft upon the latter for the purchase price. He effected the purchase, stating that he was buying for another person, but, contrary to the agreement, took a deed in blank and made payments with a certified check of his own. Shortly thereafter he inserted Stewart's name as grantee and delivered the deed. The latter reimbursed him in the proportion of the price which he had agreed to bear and acknowledged, in writing, that he held one-eighth of one-seventh "royalty" interest in trust for Sanders. MacDonald contended that, at the moment Sanders received the blank deed, title vested in himself by virtue of the failure of his warranty and the doctrine of after acquired title. The court held that the doctrine was not applicable to any part of the interest acquired and that MacDonald's proper remedy was an action for damages.

Where two persons agree to acquire land jointly, one to furnish all the money and be partly repaid by the other, the one who acquires legal title holds the undivided interest of the other in trust. The general rule in Texas is that title to land which is subsequently acquired by a grantor, who has previously purported to convey the land by a general warranty deed, vests eo instante in his grantee, but this rule does not apply where the grantor

75 Baldwin v. Root, 90 Tex. 546, 40 S. W. 3 (1897); Fretelliere v. Hinds, 57 Tex. 392 (1882); Cherry v. Farmers Royalty Holding Co., 160 S. W. (2d) 908 (Tex. Com. App.)
takes that title in trust, actual or constructive, for a third party.\textsuperscript{76} The reason for the exception is that a purchaser who relies upon the doctrine of after acquired title can thereby receive no right greater than that possessed by his grantor.\textsuperscript{77} In the present case a trust attached to Stewart’s interest when the blank deed passed to Sanders. This is an apparent avenue of escape to a grantor who has breached his warranty and, although able, does not wish to make it good in land. The same result would have followed had Sanders conveyed the interest to a bona fide purchaser after acquiring it,\textsuperscript{78} instead of agreeing to a division beforehand, notwithstanding the well settled principle that title passes to the grantee at the instant it vests in the grantor.\textsuperscript{79} However, since where a grantor owns some title a purchaser cannot be without notice if the lessee has recorded his lease,\textsuperscript{80} this method often will not be available, while there seems to be no barrier to the method followed in \textit{MacDonald v. Sanders} unless the person in Stewart’s position is guilty of fraud.

There seems to be only one possible flaw in the holding that, since Sanders had warranted only the leasehold interest, the doctrine of after acquired title did not apply to the fractional interest held in trust for Sanders. Great pains have been taken by the courts in pointing out that while royalty is an interest in land, its rights, obligations, and values are quite different from those of leasehold and other interests.\textsuperscript{81} Under a general warranty the grantor warrants title only to the particular interest which

\textsuperscript{77} Newton v. Easterwood, \textit{ibid}.
\textsuperscript{78} 12 Tex. Jur. 33 (1931); Lindsay v. Freeman, 83 Tex. 259, 18 S. W. 727 (1892).
\textsuperscript{79} 14 Tex. Jur. 901 (1931).
he purports to convey and he is not estopped to assert title to another interest which he subsequently acquires. Therefore, if the interest which Sanders took was royalty, the holding is sound. But this is not at all clear. The interest acquired was, in toto, a mineral interest and, if oil were produced from the land the lessee would be entitled to deduct one-seventh of his production and development costs before paying its owners their share. No such burden attaches to a "royalty" interest. From the court's statement of the case it seems apparent that Sanders should own a flat one-eighth of the interest jointly purchased. If this be so, he acquired a one-fifty-sixth portion of the minerals in and under the tract.

Mineral interests are the rights from which leasehold interests are carved. After a mineral owner creates a lease he still has something left over and this interest is commonly called "royalty." If the holding here was proper it seems that Sanders would have an inchoate reversionary interest in Stewart's seven-fifty-sixths, and that the latter would have only a determinable fee, the same type of estate which MacDonald took under his lease. It seems clear that neither Sanders or Stewart intended any such result. On the contrary, it appears that they intended that Stewart should take an undivided seven-fifty-sixths fee simple mineral interest. It does not seem possible for the parties to change the real character of a mineral interest by merely dubbing it "royalty" when, in fact, no such interest was ever created.

It is submitted that the court erred in refusing to carry out the intention of the parties and that the doctrine of after-acquired title should have been applied to the interest acquired by the lessor, Sanders.

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83 Tulley v. Howsley, ibid.
85 Ibid.
CONSTRUCTION OF LEASES—ESTOPPEL

In *Sinclair Prairie Oil Co. v. Campbell*\(^8^6\) plaintiff, the partial assignee of a lease of defendant's land, sought to compel the defendant to convey a mineral interest to it. The lease provided:

"...as a part of the consideration herein, ... if lessee or assigns has paid the yearly annual rental as provided herein for the said period of 20 successive years, then ... lessee or assigns is to become the owner in fee of seven-eighths of all the minerals ... and lessor will execute the proper legal conveyance to the same....

"If no well be commenced ... this lease shall terminate ... unless the lessee ... shall pay or tender ... ten cents per acre ... which shall ... cover the privilege of deferring the commencement of a well ... for twelve months.... In like manner commencement of a well may be further deferred for like periods....

"Should the first well ... be a dry hole ... if a second well is not commenced ... this lease shall terminate ... unless the lessee shall resume the payment of rentals...."\(^8^7\)

The plaintiff or its predecessors paid the required rentals for nineteen years, despite the discovery of oil on a part of the original leased tract by another partial assignee in 1936. When plaintiff tendered the twentieth payment defendant rejected it and refused to execute a conveyance. The court held that the discovery of oil in 1936 inured to the benefit of all those holding parts of the original lease and that no further payment of delay rentals was required. It thought that use of the phrase "as provided herein" in the lease indicated that the provision for maturing title was intended to operate only if no oil or gas were produced and was inserted to compensate the lessee for fruitless rental payments in such event. When production was attained the lease, by this construction, no longer provided for payment of delay rentals. The acceptance of such benefits from 1936 through 1943 was held insufficient to estop the lessor, since the plaintiff's tract had not been drilled and the court reasoned that the defendant might well have accepted them under the belief that they were

\(^8^6\) 164 Fed. (2d) 907 (C. C. A. 5th 1948).
\(^8^7\) Ibid.
tendered in lieu of the plaintiff's failure to carry out its implied duty of reasonable development, since the latter had not drilled a well.

This decision may not seem equitable, but examination discloses that it is supported by rules of construction of long standing. The purpose in construing a lease is to ascertain the true intention of the parties. This is done by considering all of its parts and giving effect to each if this can lawfully and reasonably be done.¹⁻¹ If possible, the intention must be discovered from the language used in the instrument,¹⁻² but this rule is subordinate to the principle that intention prevails, and where an instrument is ambiguous subsequent conduct of the parties may be resorted to in determining what that intent was at the time of making the lease.¹⁻³ "As provided herein" is subject to two meanings in this lease. The court adopted the technical one. It might have been construed to mean that the payment of delay rentals was intended to both delay development and mature title in fee.

In oil and gas leases it is said that time is of the essence and the rule that an instrument is to be construed most strongly against the grantor does not apply.¹⁻⁴ Instead, a lease will be construed most strongly against the lessee,¹⁻⁵ and if the language is susceptible of two constructions the one most favorable to the lessor will be adopted.¹⁻⁶ Since the plaintiff was not an original party to the lease his conduct would not seem important, and since

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defendant's acceptance of rentals was subject to two interpretations the holding is tenable under the above rules.

**Cycling Of Natural Gas—Lessee's Implied Covenants**

In *Tidewater Associated Oil v. Stott*[^94] defendant oil companies owned extensive leases surrounding land which they held under lease from plaintiffs. The defendants and their other lessors entered into unitization and recycling agreements in order to protect their leases from similar operations by others in the field. The plaintiffs, although urged to participate on the same basis as the other lessors, refused to join. It was clearly impracticable to recycle the plaintiff's wells separately, so that the defendants were able to do no more than to separate condensate at the wells. Since there was a limited market for the semi-dry gas residue and because of statutes forbidding flaring[^95], the plaintiffs' wells were restricted to lower production than those operated by defendants on adjacent tracts, which were finding ample beneficial uses for their extracted products. Dry gas, returned to the reservoir at high pressure after cracking, was replacing wet gas underneath the plaintiffs' lands by forcing it toward points of lower pressure, those points being those wells which participated in the recycling operations and consequently enjoyed greater allowables. This suit was instituted to recover damages for the resulting loss to the plaintiffs. It was admitted that the defendants had fully performed their duty to develop these leases, but the plaintiffs contended that there is an implied duty upon the lessee to refrain from injuring his lessor's lease. The court held that if such a covenant exists, it cannot prevent a lessee from operating adjacent leases to the advantage of himself and the lessors there concerned. Plaintiffs could not refuse to cooperate with their lessees for their mutual protection and benefit in the manner customary in the field, and, at the same time, demand damages. Any loss which they suffered was *damnnum absque injuria*.

The leading texts list several covenants which are implied in oil and gas leases, but none of the authorities find any duty incumbent upon a lessee "not to injure his lessor's lease." It has been suggested that there is an implied duty upon the lessee to do "everything a reasonably prudent operator should do to insure a reasonably rapid accrual of the largest royalties practicable, due consideration being given to the interests of both lessor and lessee." However, none of the authorities cited for this proposition go any farther than to uphold covenants to develop or to protect against drainage. Professor Walker contends that there should be an implied promise that a lessee will use reasonable care in drilling and operating wells on his lessor's lease, but he recognizes that even this covenant does not exist. The only statement which has been discovered supporting the lessors' contention in the principal case is a dictum in *Humphreys Oil Co. v. Tatum*, a federal decision which has been cited with approval in only one Texas case, and in a dissenting opinion in that instance. The only question involved in the *Humphreys* case was the scope of a lessee's duty to drill and protect against drainage from wells on adjacent tracts owned by the same lessee, and the statement there made, which seems to support the lessors here, was unsupported and unnecessary to the decision.

A result contrary to the principle case would, without justification, decrease the lessee's rights under nearby leases which he

96 (1) To drill test wells; (2) to reasonably develop after discovery of oil or gas; (3) to drill offset wells so as to protect against drainage. 2 Summers, *Oil and Gas* 309 (Perm. ed. 1938); *Oil and Gas*, 31-A *Tex. Jur. 222-238* (1947); Thuss, *Texas Oil and Gas* 177-178 (1929); Merrill, *Covenants Implied in Oil and Gas Leases* 29 (1926). An additional covenant, to market the product, is listed by Summers and *Texas Jurisprudence*. Summers, alone, states that the covenant to drill test wells exists even though the lease provides for payment of delay rentals, if the lessor gives notice. Thuss contends that a covenant should not be implied in such cases.


might happen to own. It is submitted that a leaseholder's rights and duties under adjacent leases are separate and distinct and should not be changed in any manner in which they could not be changed if the leases were owned by separate persons.

**Illegal Production—Commingling—Waiver**

_In Mooers v. Richardson Petroleum Co._ the defendant company owned several contiguous leases. The plaintiff owned one-half the royalty in tract A on which there were large producing wells. Some of the other leases were not producing their allowables. The defendant concealed this by constructing secret underground pipelines, by means of which it illegally overproduced tract A and supplemented its poor wells, in which the plaintiff had no interest. The plaintiff was paid one-half the royalty on the reported production of tract A, but none on oil secretly piped away. The decision raises two points of interest.

**First.** Since the defendant was unable to show clearly how much oil was illegally run from tract A, the court held that the plaintiff was entitled to damages in accordance with the equitable rule of commingled assets: the value of one-half the royalty on all the oil produced from all wells which had been secretly connected with tract A, for the entire period of commingling.

Oil and gas, when physically severed from the land by production, become personalty and are, after severance, generally subject to the same principles of law as other chattels. The court here merely applied the equitable rules relating to wilful confusion of goods. A similar principle is applied where trustees commingle many types of goods, but none of the cases cited by either the Supreme Court or the Court of Civil Appeals in the

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Mooers case involved commingling of oil and gas. Research yields only one decision in point, a very similar “hot oil” case. There the court refused to apply the rule of wilful confusion to increase a lump sum of damages awarded by the jury. Although the evidence would have supported a verdict in greater amount and although the exact amount of damages could not be determined, the court, expressly declining to decide whether the rule might be applied in different circumstances, held that the evidence was such that the jury could form a reasonably certain estimate of the amount of oil converted and that, therefore, the rule was not applicable, despite the fact that the verdict arrived at was clearly very conservative. In the principal case it was found to be impossible to establish “clearly and distinctly” the amount of “hot oil” run. The decisions are not, therefore, conflicting on principle. Since there is no reason apparent why any different rule should apply to oil and gas than to other fungible goods, the holding seems proper.

Second. If, contrary to the findings of the trial court, a right to terminate the lease had ever existed, it had been waived. After knowledge of the fraud plaintiff continued to accept royalty payments from defendant. His original petition in this suit prayed for damages and the foreclosure of a lien upon the leasehold estate. In connection therewith he had filed notice of lis pendens. It was held that the plaintiff’s knowledge at the time of suit put him to an election to either affirm the lease and sue for damages, or repudiate it and sue for termination. His actions were inconsistent with an intent to terminate and constituted an affirmance of the lease.

The principle here invoked is that of equitable estoppel. It is well settled that an irrevocable election to pursue one remedy thereafter bars a suit asking for another and inconsistent form of relief. Acceptance of the benefits of the lease, the royalty checks,
indicated that the plaintiff recognized the lease as subsisting and continuing. His original prayer asking a lien and foreclosure strengthened this inference and this latter, along with notice of lis pendens, undoubtedly had an injurious effect upon defendant's leasehold interest, thus making the election irrevocable.\textsuperscript{106}

A distinction should be noted between waiver, of which the court speaks, and equitable estoppel, the true basis of the case, since the elements of those defenses are not synonymous.\textsuperscript{107} The result, however, is sound.

\section*{Sale by Guardian of Minerals Apart from Surface}

Article 4195a, R.C.S. 1925, authorizes the sale of non-productive real estate by guardians. Research indicates that \textit{Henderson v. Shell Oil Co.}\textsuperscript{108} is a case of first impression. It interprets the statute to "clearly" authorize a guardian to convey the minerals under his ward's lands separately and apart from the surface.

There are numerous cases concerning the power of guardians to make oil and gas leases; it is generally held that an oil and gas lease amounts to a sale of a part of the corpus of the land.\textsuperscript{109} Texas (among other states) has passed a statute\textsuperscript{110} giving and regulating the power of guardians to make such leases. But in Texas, however, there is no statute expressly authorizing guardians to make an absolute conveyance of the mineral estate and there are, apparently, no cases on this point. Nevertheless, the result of the principal case was logically to have been expected in view of analogous decisions and the wording of the statute.

\begin{footnotesize}
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\item \textit{Seamans Oil Co. v. Guy}, \textit{ibid.}
\item 202 S. W. (2d) 492 (Tex. Civ. App. 1947) \textit{error granted, affirmed}, ... Tex. ..., 208 S. W. (2d) 843 (1948). The Supreme Court did not discuss this particular point, but stated that each question of law presented to the court of Civil Appeals was correctly decided by the latter.
\item 2 \textit{SUMMERS, OIL AND GAS} 4 (Perm. ed. 1938).
\item R. C. S. Art. 4192.
\end{itemize}
\end{footnotesize}
It is elementary Texas oil and gas law that those minerals are, while in place, a part of the realty and that whenever they are conveyed the conveyance of an interest in realty results;\textsuperscript{111} also, Texas decisions in some instances construe a power of sale as including the power to make oil and gas leases. For instance, in\textit{Theisen v. Robison}\textsuperscript{112} a constitutional provision authorizing the legislature to provide for the sale of University lands was held to warrant passage of statutes allowing mineral leases on such land. A constitutional provision relating to county school lands was similarly construed in\textit{Ehlinger v. Clark}.\textsuperscript{113} The power granted private corporations\textsuperscript{114} to sell, mortgage, or otherwise convey real property is held to authorize mineral leases.\textsuperscript{115} The leading case, \textit{Avis v. First National Bank of Wichita Falls},\textsuperscript{116} held that a broad power of management, sale, control, rental, and lease in a testamentary trust empowered a trustee to make oil and gas leases. This was the authority relied upon by the court in the \textit{Henderson} case.

The only cases contrary to the above decisions are those construing the scope of powers of attorney. The leading case of \textit{Bean v. Bean}\textsuperscript{117} held that a naked power of attorney to “bargain, sell, grant and convey” land did not include the power to make oil leases. The Supreme Court, in the \textit{Avis} case, distinguished and refused to apply this holding on the ground that powers of attorney are construed strictly, while wills are interpreted liberally. It is generally thought that the \textit{Avis} case limits \textit{Bean v. Bean} to situations involving powers of attorney. However, it should be noted that, in the \textit{Avis} case, the court limited its holding to the circumstances involved.

\textsuperscript{111} Texas Co. v. Daugherty, 107 Tex. 226, 176 S. W. 717 (1915).
\textsuperscript{112} 117 Tex. 489, 8 S. W. (2d) 666 (1928).
\textsuperscript{113} 117 Tex. 547, 8 S. W. (2d) 666 (1928).
\textsuperscript{114} By R. C. S. Art. 651.
\textsuperscript{115} Starke v. J. M. Guffey Petroleum Co., 98 Tex. 542, 86 S. W. 1 (1905).
\textsuperscript{116} 141 Tex. 489, 174 S. W. (2d) 255 (1943).
\textsuperscript{117} 79 S. W. (2d) 652 (Tex. Civ. App. 1935) \textit{error refused}. 
Nicholson v. Campbell decided prior to the enactment of Article 4195a, held that if the land of a minor could be sold to better advantage by dividing it into lots there was no reason to prevent the division. The statute expressly authorizes this by providing for the sale of non-productive real estate "in whole or in part." Since oil and gas in place are a part of the realty and since the statute allows the sale of a part thereof, the holding in Henderson v. Shell Oil Co. appears to be clearly correct.

1947 Statutes

Interstate Oil Compact. The Governor of Texas is authorized to execute an agreement with other member states of the Interstate Oil Compact Commission extending the Interstate Compact to Conserve Oil and Gas for a period of four years from its expiration date (September 1, 1947), subject to the approval of Congress.119

State Leases. An act was passed changing the terms of leases to be made upon state lands, including river beds, channels, unsold school lands, and all tidewater lands within the jurisdiction of the State of Texas, and providing that, for an additional consideration, existing leases upon such lands may be amended so as to benefit by the new terms. The act extends to all minerals except metals and provides that said leases are to be granted for a primary term of five years and as long thereafter as oil, gas, or other mineral covered is produced.

Before amendment, the law provided that leases on the lands covered should be limited to a period of twenty-five years even though production was continuing at the end of such period. In the purpose clause, Section 5, the legislature states its reasons for the change: a limited period encourages rapid depletion and wasteful production practices, and makes leases unattractive to bidders, thus reducing proceeds received from such leases and thereby depriving the Public School Fund of substantial revenue.

118 40 S. W. 167 (Tex. Civ. App. 1897) error refused.
119 Tex. Laws 1947, c. 52, p. 69.
Also, the legislature felt that the wasteful practices encouraged by the limited period might be seized upon by the Federal government as a basis for asserting that the state's control of tidewater areas is inconsistent with the Federal government's conservation program.120

Use of Natural Gas for Production of Carbon Black. Article 6008a, Section 3121 was amended to authorize the use of sweet gas for the production of carbon black under certain enumerated circumstances. The Railroad Commission is authorized to hold hearings and determine whether the conditions of the act are being met. The act is cumulative of existing laws covering uses of gas and all prior conflicting laws are repealed except Subdivision 2, Section 7, of Article 6008.122

Corporations for Fighting Well Fires and Blowouts. Corporations may now be formed to carry on the business of fighting fires and blowouts in oil and gas wells. Certain other types of corporations are authorized to hold stock in such new corporations.123

Production of Natural Gas. Article 6008, Sections 12, 14 and 16 are amended. Section 12 makes it the duty of the Railroad Commission to determine the status of gas production from all reservoirs in the state, to prorate and regulate production so as to prevent waste and to prevent production from exceeding market demand. Allowables are to be set each month after hearings provided for by the Act. Section 14 provides that, in certain circumstances, exceptions to Commission orders may be granted in order to adjust correlative rights where the market is seasonal or fluctuating. Section 16 makes it unlawful for any person to produce gas from gas wells in violation of valid orders of the Railroad Commission.124

W. L. P. Jr.

120 Tex. Laws 1947, c. 82, p. 139.