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A REASSESSMENT OF *TARA PETROLEUM CORP.* *V. HUGHEY*—A CASE OF TEMPORARY CONVENIENCE

Marc F. Conley*

Under the new law and the facts of Tara Petroleum Corp. v. Hughey, an Oklahoma farmer with a bargained for market price royalty lease would have received approximately \$3,300.00 in royalties for 10,000 Mcf royalty gas. If his farm had been located in Texas, Kansas, Mississippi, Montana, North Dakota, or possibly Louisiana or Arkansas, he may have received approximately \$13,000.00 in royalties for the same gas production. This Article confronts the problems inherent in the Tara decision and suggests alternatives for determining the market value calculation of royalties in light of decisions from other jurisdictions which have addressed these same problems.

I. INTRODUCTION

In 1981, the Oklahoma Supreme Court decided *Tara Petroleum Corp. v. Hughey*,¹ construing a market price gas royalty clause in an oil and gas lease. Simply stated, the court ruled that a lessee's obligation to pay royalty under a market price lease provision is satisfied by payment based upon the lessee's gas sales contract price, assuming that the con-

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1. 630 P.2d 1269 (Okla. 1981). Justice Lavender issued the written opinion, with Chief Justice Barnes, and Justices Hodges, Simms, Doolin, Hargrave, and Opala, concurring. Justices Irwin and Williams dissented without a written opinion.

tract was fair and reasonable at the time it was made.² In *Tara*, the Oklahoma court decided a diverse and controversial issue contrary to the great weight of authority from other oil and gas producing states.³

The history and development of differing lines of authority on this subject, as well as the gas market conditions which from time to time have increased litigation concerning gas contracts, have been extensively discussed by other commentators.⁴ This Article will explore this historical and economic background only as is necessary. The focus instead

2. *Id.* at 1274.

3. The Oklahoma Supreme Court noted decisions to the contrary from the Fifth Circuit, Texas, Kansas, and Montana. *Id.* at 1272 nn.4-7 (citing *J.M. Huber Corp. v. Denman*, 367 F.2d 104 (5th Cir. 1966), and *Foster v. Atlantic Ref. Co.*, 329 F.2d 485 (5th Cir. 1964) (both of which applied Texas law); *Montana Power Co. v. Kravik*, 179 Mont. 87, 586 P.2d 298 (1978); *Lightcap v. Mobil Oil Corp.*, 221 Kan. 448, 562 P.2d 1, *cert. denied*, 434 U.S. 876 (1977); *Texas Oil & Gas Corp. v. Vela*, 429 S.W.2d 866 (Tex. 1968, no writ)). In the *Montana Power* case, the lessee was also the producer, purchaser, and distributor of the gas in dispute; therefore, the entire agreement between the parties was contained in the lease. Accordingly, the Montana court was not presented a case of lessee hardship arising from a separate long-term gas contract. *Montana Power*, 179 Mont. at —, 586 P.2d at 300. Nonetheless, the Montana court's decision is instructive on the definition of "market price" which was construed as the current market price being paid for gas at the well where it was produced. *Id.* at 302. The Montana Supreme Court also addressed the method of proof of market value, stating the test as: "Where no market exists in the field, in the absence of unlawful combination or suppression of price, royalty may be computed upon receipts from the marketing outlet for the products, less the costs and expenses of marketing and transportation." *Id.* at 303 (citing *Phillips Petroleum Co. v. Bynum*, 155 F.2d 196, 198 (5th Cir. 1946); *Johnson v. Jernigan*, 475 P.2d 396, 398 (Okla. 1970); R. HEMINGWAY, *THE LAW OF OIL AND GAS* § 7.4 (1971)). *Cf.* *Lippert v. Angle*, 211 Kan. 695, 508 P.2d 920, 926 (1973) (court examines independent proof of comparable sales under similar or substantially similar conditions).

4. *See, e.g.*, Scully, *The Market Price Gas Royalty Clause: Lessee's Nightmare Outside Oklahoma*—*Tara Petroleum Corp. v. Hughey*, 35 Sw. L.J. 1079, 1083 (1982); *see generally* R. HEMINGWAY, *supra* note 3, § 7.1 (discussion of royalties for casinghead gas and its by-products under modern lease provisions). In fact, the issues litigated in *Tara* had been widely discussed prior to the Oklahoma decision, with the commentary accurately described by Justice Lavender as critical of the cases from other jurisdictions noted *supra*, note 3. *Tara*, 630 P.2d at 1273 nn.8-10. Commentary subsequent to the *Tara* decision, however, has been favorable to the *Tara* rule. *See* Lowe, *Eastern Oil and Gas Operations: Do Recent Developments Suggest New Answers to Old Problems?*, 4 E. MIN. L. INST. 20-1, § 20.03[2], at 20-32 (1983); Lowe, *Developments in Non-regulatory Oil and Gas Law: Issues of the Eighties*, 35 INST. ON OIL & GAS L. & TAX'N 1 (1984); Scully, *supra*, at 1092-94; Note, *Oil and Gas: Market Price Under a Long-Term Gas Contract*—*Tara Petroleum Corp. v. Hughey*, 35 OKLA. L. REV. 427 (1982); Note, *Market Value and Long-Term Purchase Contracts: Tara Petroleum Corp. v. Hughey*, 17 TULSA L.J. 566 (1982). Nonetheless, the case law subsequent to *Tara*, with the exception of Arkansas, *see infra* notes 179-90 and accompanying text, have rejected the *Tara* type of judicial revision of oil and gas leases to favor the lessee. Although the Louisiana decisions subsequent to *Tara* do not support *Tara's* unqualified lease construction rule, *see infra* notes 166-69 and accompanying text, some noted authors have enthusiastically grouped Louisiana with Oklahoma and Arkansas as following the *Tara* ruling. Lowe, *Eastern Oil and Gas Operations, supra* § 20.03[2], at 20-32; 3 H. WILLIAMS & C. MEYERS, *OIL AND GAS LAW* § 650.4, at 650.25-26 (1984) [hereinafter cited as WILLIAMS & MEYERS]. However, both of these sources appear to have recognized that the latest pronouncement of the Louisiana Supreme Court may take Louisiana out of the column of pro-*Tara* jurisdictions. Lowe, *Developments in Non-regulatory Oil and Gas Law: Issues of the Eighties, supra*, at 6; WILLIAMS & MEYERS, *supra*, § 650.4, at 650.26. For a further listing of related articles, *see* WILLIAMS & MEYERS, *supra*, § 650.4, at 650.17 n.9.

will be upon the extent to which the court in *Tara*, as well as courts in other jurisdictions, have been willing to engage in judicial alteration, modification, and impairment of private contracts to reach a given result.⁵

The problems involved in the exploration, production, and marketing of natural gas for profit are of relatively modern vintage. Generally, prior to World War II, the incidental discovery of natural gas by producers of oil was considered a nuisance.⁶ Since such gas had no readily available market, oil producers customarily dealt with this troublesome by-product by flaring it into the air.⁷ Subsequently, a market was created and served by a spreading national network of gas collection and distribution pipeline systems, thereby fostering the evolution of various modern gas royalty lease provisions.⁸

There are a number of material variations in standard gas royalty lease clauses describing the basis upon which the royalty owner will be paid for his proportionate share of gas production.⁹ One difficulty in comparing and contrasting principal cases determining the lessee's liability to the royalty owner has perhaps been the differing lease language involved in the disputed royalty clauses.¹⁰ For instance, in *Tara* the Oklahoma court limited its decision to a market price clause while noting common usage of royalty clauses generally described as market value, gross proceeds, net proceeds, and in kind.¹¹ These distinctions in lease clause language were developed by oil and gas lease draftsmen who, it is commonly thought, were mindful of certain policies and objectives pertaining to these lease clauses.¹² Inherent dangers exist, however, in at-

5. See *infra* notes 89-92, 121-22, 211-12 and accompanying text.

6. Morris, *The Gas Royalty Clause—What is Market Value?* 25 INST. ON OIL & GAS L. & TAX'N 63, 64-66 (1974).

7. *Id.*

8. See 3 E. KUNTZ, LAW OF OIL & GAS § 40.1, at 291 (1967) (explaining the effect of gas distribution on lease provisions).

9. Indeed, these variations make the establishment of blanket rules of construction both difficult and, as in the case of *Tara*, unwise.

10. See *infra* discussion of case law from other jurisdictions.

11. *Tara*, 630 P.2d at 1272 n.3. While the *Tara* decision at least implied that a distinction exists between market price and market value royalty clauses, the courts of other jurisdictions have generally treated the terms as synonymous. See WILLIAMS & MEYERS, § 643.2, at 525-26.

12. See, e.g., Lowe, *Eastern Oil and Gas Operations*, *supra* note 4, § 20.03[2], at 30. Still, what industry draftsmen may have had in mind in drawing standard lease clauses throws little light on the intent of the parties to any given oil and gas lease. If the source of the drafting of leases has any significance in this type of dispute, it is in the application of the rule requiring construction of a document most strictly against the party who has created the need for such construction. See *infra* notes 237-39 and accompanying text. There is little justification for considering the term "market price" to be ambiguous and in need of judicial construction. However, if the court has reached that point, then a lessee who supplies the language and terms within the lease should be held to a strict

tempting to employ printed form or boilerplate language to cover a variety of intended transactions and commercial goals. Greater precision in the drafting of gas royalty provisions over the past fifty years could likely have resulted in substantial savings in litigation costs to both lessees and lessors and, in turn, to consumers.¹³ Interestingly, the oil and gas industry has not been without highly accurate prophecies of such lease language difficulty. As A. W. Walker Jr. observed:

Too much care cannot be devoted to the preparation of a royalty clause in an oil and gas lease. The prospective payment of royalties of great monetary value is involved, potentially at least, in the drafting of every lease, and any slight error in content or terminology is apt to prove exceedingly costly.¹⁴

Still, the exigencies of the leasing industry are probably sufficient to explain most failures to heed such forecasts of lease construction problems. With leases commonly entered into between land and mineral owners on the one side, and landmen representing lessees on the other, the ready availability of a few standard lease clause provisions provided the environment for increasingly frequent litigation over gas royalty clauses. In fact, it was generally not until economic factors resulted in a drastic and rapid escalation of the market price for natural gas¹⁵ that fine distinctions in lease language began to bring to the forefront many of Mr. Walker's early concerns of more than a half century ago. In light of the discussion to follow, however, to the extent that some courts have construed patently unambiguous lease language as "ambiguous" and resolved the same by application of questionable standards of interpretation,¹⁶ it is certainly arguable that no amount of care in drafting royalty provisions would have substantially reduced the number and intensity of disputes over accountability for gas production.

II. THE *TARA* DECISION

The royalty dispute decided in *Tara* arose from an oil and gas lease

construction in favor of the lessor. See, e.g., 2 W. SUMMERS, LAW OF OIL & GAS § 232 (perm. ed. 1959); WILLIAMS & MEYERS, *supra* note 4, § 628 (1981).

13. For instance, the Kansas Supreme Court, in deciding *Lightcap v. Mobil Oil Corp.*, 221 Kan. 448, 562 P.2d 1 (1977), noted that there may have been at that time as many as three hundred similar cases pending in the Kansas district courts. *Id.* at ___, 562 P.2d at 3. See also Lowe, *Eastern Oil and Gas Operations*, *supra* note 4, at 20-29.

14. Walker, *The Nature of the Property Interests Created by an Oil and Gas Lease in Texas*, 10 TEX. L. REV. 291 (1932). Walker's concern was reiterated in 1974 by another learned commentator, Joseph W. Morris. See Morris, *supra* note 6, at 63-64.

15. Such a dramatic increase in the free market price of gas in the 1970's is illustrated in Scully, *supra* note 4, at 1079 n.4.

16. See *infra* notes 36-39 and accompanying text.

(the "Hughey lease") executed in 1973 to Tara Petroleum Corporation.¹⁷ In 1976, after unsuccessful exploration and several assignments, Wilcoy Petroleum Company began to operate the lease.¹⁸ A producing gas well was drilled that year. Prior to any production, Wilcoy contracted to sell the gas produced to Jarrett Oil Company.¹⁹ The Wilcoy/Jarrett gas purchase contract was for a two-year term with automatic year-to-year extensions. The contract was terminable at the will of either party at the end of the initial two-year term or at the end of any subsequent annual extension.²⁰ The Hughey lease gas royalty provision, described by the Oklahoma Supreme Court as a standard market price royalty clause,²¹ provided for gas royalty as follows:

In consideration of the premises the said lessee covenants and agrees:

. . . .

2nd. To pay lessor for gas of whatsoever nature and kind produced and sold or used off the premises, or used in the manufacture of any products therefrom, one-eighth ($\frac{1}{8}$) at the market price at the well for the gas sold, used off the premises, or in the manufacture of products therefrom, said payments to be made monthly²²

The Hughey well began producing gas which was sold to Jarrett under the Wilcoy/Jarrett contract until Wilcoy terminated the contract at the end of the initial two-year term.²³ Royalties paid during that two-

17. *Tara*, 630 P.2d at 1271. With the disputed lease having been entered into subsequent to fierce litigation over market price royalty clauses in other jurisdictions, the burden should have fallen even heavier upon the drafter of the lease to specifically provide a proceeds royalty clause if desired.

18. *Id.* It should be noted that the lease in question had been subject to assignments, as have many of the leases disputed in the cases discussed in this Article. The cases speak in terms of the lessor or royalty owner on the one side of the question, and the lessee, producer, operator, or working interest owner on the other. For simplification, the royalty owner will be referred to throughout as the lessor while the party bearing the obligation to pay the royalty as the lessee.

19. *Id.* The *Tara* rule includes a requirement that the gas contract be entered into at arm's length. The argument was made that Jarrett Oil Company and Tara Petroleum Corporation were jointly owned and subject to common control. *Id.* at 1275. The court indicated that had common control been approved, the lessor would have been entitled to the higher price received on resale to the related entity. In the absence of any proof of common control, the *Tara* court declined to speculate as to such common ownership. *Id.* In the event of a collusive sale between lessee and purchaser, the Oklahoma court would apparently require the lessor to meet the standard of proof for disregarding separate corporate legal entities. *Id.* The Oklahoma rule for disregarding such entities requires a showing that the separate corporation exists as a tool to perpetrate fraud or that the corporations are so organized and controlled that one is a mere instrumentality of another. *See Wallace v. Tulsa Yellow Cab Taxi & Baggage Co.*, 178 Okla. 15, 18, 61 P.2d 645, 648 (1936).

20. *Tara*, 630 P.2d at 1271. The absence of a long-term gas contract in *Tara* renders the court's discussion of industry custom and long-term contracts inconsistent and indicates the desire of the court to favor the lessee despite the actual facts.

21. *See supra* note 10 and accompanying text.

22. *Tara*, 630 P.2d at 1272.

23. *Id.* at 1271. *See supra* note 20 and accompanying text.

year period were calculated on the Wilcoy/Jarrett contract price.²⁴

During the term of the Wilcoy/Jarrett contract, Jarrett resold gas from the Hughey well to El Paso Natural Gas Company under a contract price equal to the ceiling permitted by the Federal Power Commission (FPC).²⁵ The dispute arose when the FPC ceiling price increased substantially during the term of the Wilcoy/Jarrett contract.²⁶ While Jarrett paid Wilcoy thirty-two cents per Mcf during the first year of their contract, and thirty-three cents during the second year, Jarrett received substantially greater amounts for the gas from El Paso.²⁷ In fact, during this two-year period, the El Paso/Jarrett contract price increased to almost a \$1.30 per Mcf.²⁸ At the same time, Jarrett accounted to the Hughey lessors for royalty based upon the thirty-two cents and thirty-three cents rate established by the contract with Wilcoy.²⁹

The lessors, relying on their lease's market price royalty provision, claimed royalties calculated on the El Paso/Jarrett contract price rather than on the Wilcoy/Jarrett price.³⁰ The District Court of Geer County agreed with the lessors and awarded \$18,000.00 in additional royalties, entering a money judgment against Tara (the original lessee) and Jarrett (the first purchaser), while granting judgment for the producer Wilcoy against the lessor.³¹ Tara and Jarrett both appealed; the plaintiff-lessor failed to appeal the judgment rendered in favor of Wilcoy, the producer.³² Justice Lavender of the Supreme Court of Oklahoma, with six justices concurring, reversed the trial court.³³

The Oklahoma Supreme Court framed the dispositive issue as whether a lessor with a market price gas royalty clause is entitled to royalty calculated on the highest current price in the field.³⁴ By so charac-

24. *Id.*

25. *Id.* Because of its equation of market price with proceeds under these circumstances, the Oklahoma court did not reach the question of whether regulated markets are a relevant figure in determining market price under evidence of comparable sales. *Cf. infra* notes 139-41 and accompanying text.

26. *Tara*, 630 P.2d at 1271.

27. *Id.*

28. *Id.*

29. *Id.*

30. *Id.* at 1272. The lessor's theory, based in part on an unsupported argument of the common control of Tara Petroleum Corporation and Jarrett Oil Company, did not directly address the question of whether a lessor may seek judgment against the purchaser in an arm's length transaction for additional royalties owed.

31. 630 P.2d at 1272.

32. *Id.*

33. *See supra* note 1 and accompanying text.

34. 630 P.2d at 1272. It would be unfair to the court to suggest this to be an inaccurate characterization of the dispute, in that the additional royalties actually sought in this case were so calcu-

terizing the issue, the court took an additional and unnecessary step by expanding the scope of the issue in order to determine if the producer's contract price, here the price paid Wilcoy by Jarrett, was the "market price" for the purpose of discharging the gas royalty obligation.³⁵

To reach its equation that the lease market price was equal to the producer's contract price, the court relied upon familiar commentary to find the disputed royalty provision ambiguous and, therefore, in need of further interpretation.³⁶ Arguably the provision was unclear. If the royalty was to be based upon the producer's proceeds, clear standardized language was available to achieve that end³⁷ but was not employed in the lease. Similarly, standard lease provisions existed for royalty to be based on market value.³⁸ Nonetheless, in construing market price as used in the Hughey lease, the court engaged in an analysis of questionable validity, previously and subsequently rejected by well-reasoned decisions of other jurisdictions.³⁹ Upon suggesting that the disputed lease term was ambiguous,⁴⁰ the court employed consideration of industry practices which it felt practically and fairly supported its result but which simply were inapplicable to the facts in evidence.

Noting the producer's duty to market gas from a producing well,⁴¹ the court observed the usual necessity of entering into long-term gas

lated. No Oklahoma decision has to date combined a dispute over a market price royalty clause with the question of whether the lessee is obligated to seek the prevailing price for the lessor's gas. The United States District Court for the Western District of Oklahoma indicated such a duty does exist in *Craig v. Champlin Petroleum Co.*, 300 F. Supp. 119, 125 (W.D. Okla. 1969), *aff'd*, 421 F.2d 236 (10th Cir. 1970). The court in *Craig* relied in part upon *Young v. West Edmond Hunton Lime Unit*, 275 P.2d 304 (Okla. 1954). However, the Oklahoma cases commonly known as the *West Hunton Lime* cases, which culminated in *Olansen v. Texaco, Inc.*, 587 P.2d 976 (Okla. 1978), dealt with the obligation of the operator under a statutorily created unit. These cases are inextricably entwined with constitutional questions relating to compulsory unitization statutes. *Olansen*, 587 P.2d at 982-83. Whether or not these principles apply to the relationship between a lessor and lessee in the absence of compulsory unitization is beyond the scope of this Article.

35. *Tara*, 630 P.2d at 1272-73.

36. The Oklahoma court cited 3A W. SUMMERS, OIL & GAS § 589, at 22-23 (2d ed. W. Flittie Supp. 1980), as characterizing the typical market price royalty clause as "freighted with inherent ambiguity." *Tara*, 630 P.2d at 1273.

37. See WILLIAMS & MEYERS, *supra* note 4, § 643.2, at 526-27. The Oklahoma court recognized the existence of other such typical gas royalty clauses. *Tara*, 630 P.2d at 1272 n.3.

38. See WILLIAMS & MEYERS, *supra* note 4, § 643.2, at 525-26.

39. See *infra* notes 194-97 and accompanying text.

40. The court did not directly rule that the term market price in a royalty clause is ambiguous. Nonetheless, authority is quoted within the text of the opinion to that effect. See *supra* note 36 and accompanying text.

41. *Tara*, 630 P.2d at 1273 n.11 (citing *McVicker v. Horn, Robinson, & Nathan*, 322 P.2d 410, 414 (Okla. 1958)).

purchase contracts.⁴² Additionally, the lessor and lessee were presumed to possess knowledge of this practice when negotiating the lease.⁴³ Thus, the court reasoned that while gas prices may fluctuate substantially, the producer's revenues remain constant.⁴⁴ Therefore, the producer was held to be unfairly treated by any ruling which would result in the lessor's royalty share taking a steadily increasing portion of the producer's revenue.⁴⁵ In fact, the Wilcoy/Jarrett contract was of two years duration, and was terminated after that initial term. Whatever inherent inequity may arise from requiring a lessee to account for royalties independent of the proceeds received under a ten-year or twenty-year term gas purchase contract,⁴⁶ those inequities simply did not exist in *Tara*.⁴⁷

It is true that, under the facts of *Tara*, if market price had been determined to be the El Paso/Jarrett contract price, the lessor's royalty would have eventually equaled approximately one-half of Wilcoy's revenues.⁴⁸ As noted above,⁴⁹ however, this result could have been avoided without reaching the imprudent equation of contract and market price.

42. *Id.* n.12 (citing Apache Gas Prods. Corp. v. Oklahoma Tax Comm'n, 509 P.2d 109, 113 (Okla. 1973)).

43. *Id.* at 1273. The existence of such knowledge, if properly charged to both parties to the lease, particularly within the time frame of the *Tara* dispute, should place a greater burden of using specific language on the drafter of the lease.

44. *Id.*

45. *Id.* This finding of unfairness is countered by the reasoning of the Fifth Circuit in Piney Woods Country Life School v. Shell Oil Co., 726 F.2d 225 (5th Cir. 1984), which concluded the *Tara* rule to be unfair to lessors on the basis that the lessor may elect a royalty based on a smaller fraction of market price, rather than a greater portion of proceeds, upon an expectation that market price will increase. *Id.* at 237. The Fifth Circuit reasoned that *Tara's* rearrangement of the contractual relationships between the lessor and the lessee destroyed the bargained for expectation of the lessor in this instance. *Id.*

46. Under traditional contract law concepts, such unfairness has never been the basis for relieving a party of its contractual obligation when market fluctuations have made performance of the agreement unprofitable. See Foster v. Atlantic Ref. Co., 329 F.2d 485, 489 (5th Cir. 1964). This rule has been followed for many years in Oklahoma. See, e.g., Cosden Oil & Gas Co. v. Moss, 131 Okla. 49, 53, 267 P. 855, 859 (Okla. 1928); Clements v. Jackson County Oil & Gas Co., 61 Okla. 247, 250, 161 P. 216, 218 (Okla. 1916). It is worth noting that these cases distinguish between physical impossibility, which can under certain circumstances justify avoidance of a contract, and mere financial inability of a party to perform, which is no defense. Accordingly, the Oklahoma Supreme Court ruled in *Clements*:

If contracts could be repudiated upon the mere allegation that the other party had no funds [sic] there would, indeed, be much consternation in the business world, for it is common knowledge that many persons worth large amounts and with extensive borrowing power may be at some times without funds and yet far from insolvent and far from unable to meet their contractual payments.

Clements, 61 Okla. at 250, 161 P. at 218.

47. See *supra* note 20 and accompanying text.

48. *Tara*, 630 P.2d at 1273.

49. See *infra* notes 57-59 and accompanying text.

Notwithstanding, there is little justification for the court's conclusion that the lessor and lessee could never have contemplated such a dramatic increase of royalty to be paid from the producer's constant revenues.⁵⁰ Such an intent should, where possible, be drawn from the wording of the lease in dispute.⁵¹ If the royalty were to be calculated upon the proceeds, then language was readily available to these parties to so provide.

The court went on to rationalize its interpretation of market price as "consonant with the intent and understanding of parties to oil and gas leases."⁵² Whatever the intent and understanding of lessors and lessees in general may be, there is no indication that evidence was introduced in this case that these particular parties ever intended the royalty payment to be based upon the producer's contract price. Further, the court determined its interpretation to be the only fair one for producers in general although not unfair to lessors.⁵³ This conclusion, of questionable validity in determining the intent of the parties to the Hughey lease,⁵⁴ is accurate only to the extent that the court's underlying premises are acceptable. In recognizing the binding nature of long-term gas purchase contracts in the face of escalating gas prices,⁵⁵ the court concluded that any other rule would act to penalize the lessee who is required, by his duty to the lessor, to market gas production.⁵⁶

It seems apparent that the court's desire to equate the lease royalty market price with the producer's contract price resulted in an interpretation of the disputed lease provision which, in addition to placing the lessor in a detrimental position, acted essentially to rewrite the lease to conform to the agreement which the lessee might well have bargained for

50. An excellent discussion of such contemplation is found in the Fifth Circuit case of *Piney Woods Country Life School v. Shell Oil Co.*, 726 F.2d 225, 237 (5th cir. 1984); see also *infra* notes 191-212 and accompanying text.

51. See *infra* notes 219, 223 and accompanying text.

52. *Tara*, 630 P.2d at 1274.

53. *Id.* The court noted:

Quite naturally lessors want to receive as much royalty as possible, but lessees in their own interest seek as good a price as they can get for gas. As long as the contract was reasonable when entered into, and as long as our law recognizes long-term gas purchase contracts as binding in the face of escalating prices, the law should not penalize the producer who was forced into the contract in large measure by his duty to the lessor [to market the gas].

Id.

54. The inquiry of the court should have been to determine the intent of the actual parties to the agreement and not general intentions of parties in similar transactions.

55. *Tara*, 630 P.2d at 1274.

56. *Id.* If the parties are to be charged with knowledge of marketing requirements for gas production, certainly the lessee must be bound to know his duty to market gas production at the time the lease is entered into. The lessee is not forced to enter into a market price lease, and subsequent enforcement of the known duty to market is not a basis for relief from an imprudent contract.

had it accurately forecast gas price escalation.⁵⁷ It should be emphasized that no such question was presented, nor needed to have been ruled upon, in the context of this dispute. The court itself noted that the lessor had not sought royalties based upon a price received by other lessors in the field.⁵⁸ Instead, the Hughey lessors attempted to make a case for the recovery of royalties calculated upon the highest currently-paid price for this particular gas, here the El Paso/Jarrett contract price which happened to reflect the FPC maximum ceiling price.

It would have certainly been a simple matter, and not inconsistent with well-reasoned and broadly recognized authorities on this subject, to deny relief on this basis.⁵⁹ Admittedly, in light of the availability of specific market value royalty provisions,⁶⁰ the market price term may mean something else entirely. However, under the lessor's theory in this case, the court had no need nor any obligation to determine market price to be equivalent to the highest current price in the field. Such relief might arguably have been permissible if evidence had been presented indicating that the El Paso/Jarrett, or the FPC ceiling price, represented the fair market value of the lessor's gas or at least some other equivalent which could be fairly encompassed by the term "market price". No indication appears in the court's decision, however, that any such theory was pur-

57. Interestingly, the earliest and the most recent cases from other jurisdictions have expressly declined to alter a contractual relationship between the parties due to a perceived hardship. *See Piney Woods Country Life School v. Shell Oil Co.*, 726 F.2d 225 (5th Cir. 1984); *Foster v. Atlantic Ref. Co.*, 329 F.2d 485 (5th Cir. 1964). For further discussion of these cases, *see infra* notes 85-92, 191-212 and accompanying text.

58. *Tara*, 630 P.2d at 1272.

59. The jurisdictions which have followed a rule contrary to *Tara* and have sought to determine market price based on evidence of comparable sales have looked to many factors to determine what that market price might be. *See, e.g.*, *Hugoton Prod. Co. v. United States*, 315 F.2d 868 (Ct. Cl. 1963). The *Hugoton* court noted the following factors:

(a) The volume available for sale. Generally, the greater the volume or reserves, the greater the price the seller could command.

(b) The location of the leases or acreage involved, whether in a solid block or scattered, and their proximity to prospective buyers' pipelines.

(c) Quality of the gas as to freedom from hydrogen sulphide in excess of 1 grain per 100 cubic feet.

(d) Delivery point.

(e) Heating value of the gas.

(f) Deliverability of the wells. The larger the volume that could be delivered from a reserve, the greater the price the seller could command.

(g) Delivery or rock pressure. The higher the pressure, the less compression for transportation is required.

Id. at 894-95.

In the absence of any attempt to prove fair market price, the Oklahoma court would not seem to have been under any compulsion to conclude that the fair market price was the highest price being paid in the field.

60. Nonetheless, courts which have dealt with the terms "market value" and "market price" have tended to treat the terms as interchangeable.

sued or that any such evidence was presented. Therefore, a straightforward ruling that market price and the highest current field price were not synonymous would have adequately disposed of the lessor's claim.

In going beyond the facts of the case by stressing the burdens of long-term gas purchase contracts when only a two-year contract was before it, the court's bias in favor of lessees becomes apparent. Having divined the general understanding of hypothetical lessors and lessees with respect to the necessity of long-term gas contracts, the court concluded that neither lessor nor lessee could possibly have contemplated holding the producer under a market price gas royalty clause to an increasing price in the field while the lessee's own revenues were fixed by its gas contract.⁶¹ On the other hand, an opposite conclusion is equally justified. The lessee, here a corporate producer, must certainly be charged with knowledge of its duty to market gas production and of the possibility of binding long-term gas contracts. If the lessee, in its agreement with the lessor, wished to limit its liability to a fixed portion of its proceeds under its gas contract, it is reasonable to believe that any prudent lessee would have done so. It is not consistent with the reasonable intentions and care attributable to lessees in general in negotiating their leases⁶² to believe that, in the face of these recognized market conditions, the lessee would have been content to rely upon a market price clause to achieve this end.

Finally, the court limited the applicability of its equation of lease market price and gas contract price to those instances where the contract was fair and reasonable at the time it was entered into.⁶³ Such a limitation is superfluous, however, since the gas contract must have been negotiated at arm's length to prevent the possibility of fraud arising from illusory or collusive dispositions of gas production. Accordingly, where the lessee enters into a gas purchase contract with a related entity, which entity in turn resells the gas at a higher price, the lessor's royalty must be calculated upon that higher price.⁶⁴ However, as has been observed by subsequent case law highly critical of the *Tara* decision,⁶⁵ a lessee always has the obligation to market the gas diligently and in good faith.⁶⁶

61. *Id.* at 1273.

62. *See infra* notes 201-05, 237 and accompanying text.

63. *Tara*, 630 P.2d at 1274.

64. *Id.*

65. *Piney Woods Country Life School v. Shell Oil Co.*, 726 F.2d 225, 237 (5th Cir. 1984); *Matzen v. Cities Serv. Oil Co.*, 233 Kan. 846, —, 667 P.2d 337, 344 (1983).

66. As was noted by the Fifth Circuit in *Piney Woods*, the lessor would not be bound by a contract price which had not been negotiated in good faith. *Piney Woods*, 726 F.2d at 235.

Therefore, these limitations upon the court's decision in no sense reduce the basic unfairness arising from the rewriting of the Hughey lease to the benefit of the lessee and the detriment of the lessor.

Subsequent sections of this Article will deal with decisions preceding and following *Tara*, the majority of which have found the reasoning employed by the Oklahoma Supreme Court to be unpersuasive.⁶⁷ In fact, the court in *Tara* noted authority from four jurisdictions which have held to the contrary⁶⁸ while failing to cite any relevant authority in support of its decision. The court did find its holding to be consistent with an earlier Oklahoma case, *Apache Gas Products Corp. v. Oklahoma Tax Commission*,⁶⁹ as well as a Tenth Circuit case, *Pierce v. Texas Pacific Oil Co.*⁷⁰ Nevertheless, neither of these cases deals with the basic underlying issue of *Tara*, the intent of the parties to an oil and gas lease.

Apache Gas Products construed a provision of the Oklahoma Gross Production Tax Act⁷¹ regarding the calculation of gross production tax upon gas sold under circumstances where the sales price failed to represent the prevailing cash price for gas of the same kind, character, and quality in the field.⁷² The court ruled that the tax should be applied to gross proceeds realized from gas purchase contracts except where the contract was not entered into at arm's length or was not the result of reasonably prudent bargaining.⁷³ While it is apparent that some of the underlying reasoning overlaps that of *Tara*,⁷⁴ the decision in *Apache Gas Products* centered entirely upon the construction of a statute in light of legislative intent⁷⁵ and has no applicability to determining the intent of the parties in entering into an oil and gas lease. Interestingly, in reaching its decision, the *Apache Gas Products* court drew upon a similar Texas statute, plus Texas cases construing the statute.⁷⁶ The irony is that market value royalty disputes have been commonly litigated in Texas, and its courts have consistently rejected the type of argument and oil and gas

67. See, e.g., *infra* notes 191-212 and accompanying text.

68. See *supra* note 3 and accompanying text.

69. 509 P.2d 109 (Okla. 1973).

70. 547 F.2d 519 (10th Cir. 1976).

71. OKLA. STAT. tit. 68, § 1009 (1981).

72. *Apache Gas Prods.*, 509 P.2d at 110.

73. *Id.* at 116.

74. The Gross Production Tax Act dealt with gas sales which were not at the prevailing price, and the court was faced with the difficulty of determining prevailing price at the time of production in the face of fixed price, long-term gas contracts. *Id.* at 113.

75. *Id.*

76. *Id.* The court cited the Texas decision of *W.R. Davis, Inc. v. State*, 142 Tex. 637, 180 S.W.2d 429 (1944, no writ), construing what is described as the Texas counterpart of the Oklahoma statute, TEX. STAT. ANN. art. 7047b (Vernon 1941).

lease construction accepted in *Tara*.⁷⁷

Unlike the decision in *Apache Gas Products*, the Tenth Circuit decision in *Pierce* presented a closer question to that involved in *Tara*. The Court of Appeals for the Tenth Circuit interpreted an Oklahoma statute regarding oil and gas communitization⁷⁸ as construed by the Oklahoma Supreme Court in *Shell Oil Co. v. Corporation Commission*.⁷⁹ The decision in *Pierce* is inextricably entwined with legislative intent and judicial construction of the Oklahoma statute in question.⁸⁰ In fact, the Tenth Circuit noted that even if the intent of the lessor in entering into his lease were appropriately considered, the lessor had argued that he intended to have a market price, as distinguished from a gross proceeds, lease.⁸¹ The court dismissed this argument as having no effect, observing that, even if the lease contained a market price royalty clause, market price and gas sales contract price are synonymous.⁸² Since the *Apache Gas Products* case does not, on its face, address lease construction, it is not unreasonable to suggest that the Tenth Circuit's reliance was misplaced. The decisions in *Apache Gas Products* and in *Pierce* come full circle when relied upon by the Oklahoma Supreme Court in *Tara* as applying inapplicable facts and inapplicable law to reach a result which is unfortunately detrimental to the mineral owners of Oklahoma.

III. CASE LAW OF OTHER JURISDICTIONS

The *Tara* court noted that other jurisdictions had taken a contrary view when in fact, at that time, no other court had reached the rule to be established in *Tara* that market price and proceeds are equivalent in an oil and gas lease royalty clause.⁸³ Since *Tara*, only Arkansas clearly and without reservation adopted the *Tara* rule; however, even Arkansas has subsequently retreated from its earlier pro-*Tara* stand.⁸⁴ The remainder of this Article will reexamine *Tara* in light of the case law of the other

77. See *infra* notes 85-116 and accompanying text.

78. OKLA. STAT. tit. 52, § 87.1(d) (1969) (amended by OKLA. STAT. tit. 52, § 87.1(d) (Supp. 1984).

79. 389 P.2d 951 (Okla. 1963). This decision is commonly known in the industry as the *Blanchard Case*.

80. The royalty obligations under the communitization statute interpreted in *Pierce* arose by statute, and should, in logic, not be controlling with respect to a question of determining the intent of the parties to a lease.

81. *Pierce*, 547 F.2d at 521.

82. *Id.* (citing *Apache Gas Prods. Corp. v. Oklahoma Tax Comm'n*, 509 P.2d 109 (Okla. 1973)).

83. See *infra* notes 85-92, 101-16, 123-31, 142-53 and accompanying text.

84. See *infra* notes 179-94 and accompanying text.

jurisdictions, and will suggest criteria by which these disputes may be resolved by ascertaining and enforcing the intent of the parties.

A. Interpretations Under Texas Law

1. *Foster v. Atlantic Refining Company*

In the mid-1960's, the United States Court of Appeals for the Fifth Circuit, applying Texas law, rendered two decisions which the Oklahoma Supreme Court in *Tara* described as "seminal" on the market value royalty question.⁸⁵ While both of these cases were rejected in *Tara*, they are the foundation of a solid and continuing line of authority defining "market value". In *Foster v. Atlantic Refining Co.*,⁸⁶ the court applied Texas law in the construction of a market price gas royalty clause. The disputed royalty clause in the *Foster* lease provided royalties for gas "at the market price therefor prevailing for the field where produced when run."⁸⁷ The lessors in *Foster* were thus armed with fairly precise language in seeking increased royalties above their percentage of the proceeds under the lessee's 20-year gas sales contract. As a result, the court was interpreting lease language considerably more explicit than the language construed in *Tara*. The court had no difficulty in finding the obligation of the *Foster* lessee to be express and without ambiguity.⁸⁸ As such, the lessee was presumed to be fully aware of the possibility of a divergence between its gas contract price and the market price for gas prevailing in the field at the time when the gas production was run. The court did not find the lessee's failure to protect its profit from increases in

85. *Tara*, 630 P.2d at 1272 n.4 (citing *J.M. Huber Corp. v. Denman*, 367 F.2d 104 (5th Cir. 1966); *Foster v. Atlantic Ref. Co.*, 329 F.2d 485 (5th Cir. 1964)). Although these are not the earliest cases discussed in this Article, the earlier cases, arising out of Louisiana, involved an inverse of the market conditions which existed during the *Tara* dispute, *i.e.* market prices significantly below the lessee's gas contract proceeds. See *infra* notes 142-60 and accompanying text.

86. 329 F.2d 485 (5th Cir. 1964). In as much as this Article is highly critical of the result in *Tara*, in all fairness, an important distinction will be discussed with respect to *Foster* namely, the more precise language of the lease royalty provision.

87. *Id.* at 488. Such precise terminology avoids the argument that market price royalty is to be calculated at a value fixed at the time of the lessee's gas contract.

88. *Id.* at 489. The court pointedly observed:

The inability of [the lessee] to make a gas sales contract with escalation provisions is beside the point. The obligation of [the lessee] to pay royalties is fixed and unambiguous. It made the gas sales contract with full knowledge of this obligation and did nothing to protect itself against increases in price. The fact that its purchaser would not agree to pay the market price prevailing at the time of delivery does not destroy the lease obligation.

Id. The *Foster* court did not, therefore, indulge in a result-oriented type of judicial construction of the lease language by viewing the royalty obligation as mutable based upon subsequent economic conditions.

the market price of gas to constitute justification for rewriting the lease,⁸⁹ even though the court was not unmindful of the realities of marketing gas production, particularly the necessity of entering into long-term gas contracts.⁹⁰ Nonetheless, while the Oklahoma court in *Tara* accepted market place realities in relieving the *Hughey* lessee of the burden of the contract it had made,⁹¹ *Foster* recognizes that established principles of law prohibit judicial restructuring of a contract simply because the obligations of one of the parties has become "financially burdensome."⁹²

2. *J.M. Huber Corporation v. Denman*

Two years after *Foster*, the Court of Appeals for the Fifth Circuit was again called upon to apply Texas law to a market price royalty clause in *J.M. Huber Corp. v. Denman*.⁹³ The gas royalty in question arose from production from different leases, with the greatest part of the production from a lease providing for royalty based upon the market price of gas produced from the well.⁹⁴ The remaining leases provided a royalty calculated on "the market value in the field."⁹⁵ The court failed to find any significance in the distinction between market price and market value.⁹⁶ As in *Foster*, the *Huber* court did not encounter any diffi-

89. *Id.* The language of the court, which has been subsequently quoted by many of the decisions following this rule, is centered around the traditional concepts of performance of financially burdensome contracts:

Stripped of all the trimmings [the lessee's] position is simply: We cannot comply. This is no answer. The lease calls for royalty based on the market price prevailing for the field where produced when run. The fact that the ascertainment of future market price may be troublesome or that the royalty provisions are improvident and result in a financial loss to [the lessee] "is not a web of the Court's weaving." [The lessee] cannot expect the court to rewrite the lease to [its] satisfaction.

Id. at 490 (citing *Phillips Petroleum Co. v. Bynum*, 155 F.2d 196, 198 (1946), *cert. denied*, 329 U.S. 714 (1946)).

90. *Id.* at 488. The court noted further that the claim by the lessee that the long-term contract was not improvident when entered into begged the question. *Id.* at 488-89.

91. *See supra* notes 41-51 and accompanying text.

92. *Foster*, 329 F.2d at 489-90. The court emphasized that when the lessee "made the gas sales contract, [it] took the calculated risk of that contract producing royalties satisfactory to the lease terms." *Id.* at 489.

93. 367 F.2d 104 (5th Cir. 1966). The decision is reported in conjunction with *Weymouth v. Colorado Interstate Gas Co.*, 367 F.2d 84 (5th Cir. 1966), a dispute involving different parties but concerning the same issues with respect to market price royalties. *Weymouth* also presented an early consideration of the jurisdiction of the Federal Power Commission to determine royalty rates with respect to gas sales in interstate commerce. *Id.* at 101-03. The history of this controversy, ultimately resolved in favor of the applicability of state law to lease clause interpretation, is discussed fully by the Kansas Supreme Court in *Lightcap v. Mobil Oil Corp.*, 221 Kan. 448, 562 P.2d 1 (1977), *cert. denied*, 434 U.S. 876 (1977). *See infra* note 123.

94. 367 F.2d at 106.

95. *Id.* at 107 n.4.

96. *Id.* at 107 n.5, 109-10.

culty in accepting a recognized definition of market price. Accordingly, the lessor was entitled to a royalty based upon current market price—a price arising from an arm's length transaction between willing seller and purchaser, the one not being compelled to sell nor the other compelled to buy.⁹⁷

Perhaps in recognition of the obstacle raised by the decision in *Foster*, the lessee in *Huber* made no attempt to equate the disputed market price clause with a proceeds royalty clause. Instead, the lessee urged that the purchaser under its gas contract constituted the sole market for this gas; therefore, the gas contract price and market price, as that term was used in the leases, were one and the same.⁹⁸ However, evidence of a rejected draft of the disputed lease revealed that the market price clause ultimately entered into had replaced an express royalty provision based upon "net proceeds derived from the sale of gas."⁹⁹ Where the parties themselves, through extensive negotiations aided by experienced oil and gas lawyers, had recognized a difference between a proceeds clause and a market price clause, the court could not find it within its province to disregard such a plain and obvious distinction.¹⁰⁰

97. *Id.* at 109. The court held:

But the "market" as the descriptive of the buyer or the outlet for the sale is not synonymous with its larger meaning in fixing price or value. For in that situation the law looks not to the particular transaction but the theoretical one between the supposed free seller *vis-a-vis* the contemporary free buyer dealing freely at arm's length supposedly in relation to property which neither will ever own, buy or sell.

Id. While applying this traditional definition of market price, the court noted that the highly regulated gas industry presented with something less than a free market. *Id.* at n.14 (citing *Weymouth v. Colorado Interstate Gas Co.*, 367 F.2d 84 (5th Cir. 1966)).

98. *Huber*, 367 F.2d at 109. In fact, the lessor had required a gas purchase contract to be entered into as a condition precedent to, and as partial consideration for, the lease. *Id.* at 110. Accordingly, the lessee argued that the lessor's actions in acquiring the particular gas contract in question constituted an adoption and ratification of the lessee's contract as the sole market, as well as an estoppel to assert any other market in this context. *Id.* at 109.

99. *Id.* at 109.

100. *Id.* Contrary to the Oklahoma court's suggestion in *Tara* that market price is a term fraught with ambiguity, the *Huber* court viewed the expressions of market price and market value to be generally well recognized in oil and gas law, and to be given their literal meaning. *Id.* The court did not discuss the construction of the language of the clause in terms of an ambiguity. Rather, the court examined whether the language was meant in its usual and ordinary sense, or as urged by the lessee, in an altered sense dictated by the conduct of the parties. Contrary to the lessee's position, the *Huber* court found ample evidence that the parties themselves intended the ordinary meaning of market price:

[T]he Lessee-Producer's reported declarations made through its general counsel—a voice not only of management, but with an articulate awareness of the significance of legal terms—clearly put its construction of a market, not a proceeds, basis on this royalty clause. There were similar representations made to the FPC that under its gas leases "it is obligated to pay royalty based on the market price at the wellhead."

Id.

3. *Texas Oil & Gas Corporation v. Vela*

The Supreme Court of Texas squarely addressed the construction of a market price royalty clause in *Texas Oil & Gas Corp. v. Vela*.¹⁰¹ This 1968 decision involved a lease and a gas purchase contract created for a term co-existent with the life of the lease.¹⁰² Interestingly, the *Vela* lease contained a combination of the various types of royalty provisions—market price, market value, and net proceeds.¹⁰³ The dispute, however, arose from the construction of the royalty clause pertaining to wells which produced gas only and which provided for payment to the lessor based upon market price.

The Texas Supreme Court was confronted with arguments similar to those raised by the lessee in *Foster*, as well as those which were to arise subsequently in *Tara*. Indeed, the facts in *Vela* appear much harsher to the lessee than those presented in *Tara*. The gas contract price in *Tara* was applied to satisfy the market price royalty clause as long as the contract was found to be fair and reasonable at the time it was entered into.¹⁰⁴ On the other hand, the gas contract in *Vela* was entered into with the only purchaser of gas in the field and at the only price available.¹⁰⁵ Thus, the lessee's arguments regarding the necessity of long-term gas contracts were buttressed by the availability of but a single market. Further, it was accepted on appeal that the *Vela* lessee's gas contract was entered into in good faith and in pursuit of its duty to market gas produced under the lease.¹⁰⁶

Despite these apparently harsh mitigating circumstances, the court appeared to reach easily the conclusion that the terms of the lease were plain and that the use of various combinations of royalty provisions evidenced the parties' ability to provide for a proceeds royalty when de-

101. 429 S.W.2d 866 (Tex. 1968, no writ).

102. *Id.* at 868.

103. The royalty on gas from oil wells and used by the lessee for the manufacture of gasoline was based upon market value; the royalty for such gas sold by the lessee was based upon net proceeds. *Id.* at 870-71. The operative provision in dispute, however, concerned a royalty from gas wells which was to be based upon market price. *Id.* at 868.

104. *Tara*, 630 P.2d at 1274. See also *supra* notes 63-66 and accompanying text.

105. The *Vela* court described the market conditions in the following manner:

When the Nordan & Morris contracts were made, however, United was the only commercial purchaser of gas in the field. The operators could market their gas only on a "life of the lease" basis, and the price stipulated is the only price that could be obtained at that time. [G]as [was] not sold on a day-to-day basis, and . . . any substantial volume [could] be marketed only under a long-term contract that fixe[d] the price to be paid throughout its term.

429 S.W.2d at 870.

106. *Id.* at 870, 876.

sired.¹⁰⁷ Consequently, the gas contract price did not necessarily coincide with the market price. That the plain wording of the lease resulted in financial burden to the lessee did not excuse performance of the lessee's obligation to pay royalty to the lessor based upon a market price¹⁰⁸ determined by comparable sales of gas in time, quality, and availability of markets.¹⁰⁹

4. *Exxon Corporation v. Middleton*

The Texas Supreme Court relied heavily upon its holding in *Vela* to resolve a different lease construction problem in *Exxon Corp. v. Middleton*.¹¹⁰ This 1981 decision required a determination of whether a sale of gas in the field, but not on the leased premises, was a sale either at the well or off the premises.¹¹¹ Therefore, *Middleton* does not actually shed any light upon the question of whether the lease market price equals the producer's gas contract price.

The thrust of the lessee's position in *Middleton*, however, had the same effect as the market price versus contract price dispute in *Tara*. The lessee asked the court to find that gas had been sold within the meaning of the market price royalty provision at the time the lessee's gas contract was entered into, rather than at the time the production was run and delivered to the purchaser.¹¹² This position would necessarily have

107. The court stated:

It is clear then that the parties knew how to and did provide for royalties payable in kind, based upon market price or market value, and based upon the proceeds derived by the lessee from the sale of gas. They might have agreed that the royalty on gas produced from a gas well would be a fractional part of the amount realized by the lessee from its sale. Instead of doing so, however, they stipulated in plain terms that the lessee would pay one-eighth of the market price at the well of all gas sold or used off the premises.

Id. at 871.

108. *Id.*

109. The court, as had the Tenth Circuit in *Foster*, rejected any implication that the market price was based upon the gas having been sold at the time the contract was entered into, accepting instead the time of delivery as the focal point for determining comparable sales. Evidence of such comparable sales was presented in the form of expert testimony based upon a mathematical average of prices paid in the field. *Id.* at 872. While the court indicated that such a mathematical average may not be the best evidence of market value at a particular time, the expert's testimony, which had been subjected to full cross-examination, was not rebutted and sufficiently supported the trial court's acceptance of the mathematical average as the market price of the lessor's gas. *Id.* at 873.

110. 613 S.W.2d 240 (Tex. 1981), *rev'd and remanded*, 619 S.W.2d 477 (Tex. Civ. App. 1981—Houston, dismissed per stipulation).

111. *Id.* at 242. The royalty clause in dispute provided for the market value of gas sold or used off the premises and for the amount realized from a sale of gas sold at the well. *Id.* The court determined, contrary to the lessee's position, that gas sold in the field, but not on the leased premises, required royalty to be paid based upon market value rather than amount realized. *Id.* at 243.

112. This argument was based upon the practicalities of industry requirements of long-term gas contracts. However, the *Middleton* court, as had the courts in *Foster* and *Vela*, rejected these matters as irrelevant to construction of the lease language, noting that, for the purposes of the gas

resulted in the market price being fixed when the lessee entered into its gas contract. Presumably, under this construction, while the gas contract itself would not have been conclusive with respect to market price,¹¹³ the market price would not have been affected by fluctuations in price occurring long after the commitment of the gas production to a long-term contract.

The Texas court found the lessee's arguments concerning the practicalities of gas marketing unconvincing. Rather, the lessee's arguments were apparently construed as simply another approach attempting to avoid burdensome obligations under the lease resulting from the lessee's failure to protect itself in negotiating its gas contract from market fluctuations.¹¹⁴

Regardless of whether the Texas court's determination of when gas is sold within the meaning of a royalty clause is viable in Oklahoma,¹¹⁵ *Middleton* exemplifies the unwillingness of courts to rewrite plain and unambiguous contract terms. The court in *Tara* would have benefited from recognizing, as did the court in *Middleton*, that "[i]f the parties intended royalties to be calculated on the amount realized standard, they could and should have used *only* a 'proceeds-type' clause."¹¹⁶

B. Interpretations Under Kansas Law

1. *Waechter v. Amoco Production Company*

In 1975, the Kansas Supreme Court determined a lessors' class action suit for increased royalties in *Waechter v. Amoco Production Co.*¹¹⁷

contract, sale may have occurred upon the effective date of the contract. That concept would not provide a basis for altering the plain language of the lease. *Id.* at 245.

113. The court adopted the definition of market value which was employed in *Foster* (citing *Polk County v. Tenneco, Inc.*, 554 S.W.2d 918 (Tex. 1977), *on remand*, 560 S.W.2d 416 (Tex. Civ. App. 1977—Beaumont)), as well as the *Vela* rule, *see supra* notes 108-09 and accompanying text, regarding proof of market value by comparable sales. *Middleton*, 613 S.W.2d at 246.

114. The court observed:

When Exxon negotiated the gas contracts, it took the risk that the revenue therefrom would be sufficient to satisfy its royalty obligations. That subsequent increases in market value have made these obligations financially burdensome is no reason to compel this Court to disregard the plain and unambiguous terms of the royalty clause and rewrite it to conform to the meaning that Exxon, as drafter of the language, says was intended.

613 S.W.2d at 245 (citing *Foster v. Atlantic Ref. Co.*, 329 F.2d 485 (5th Cir. 1964)).

115. Because of the rule it set out in *Tara*, the Oklahoma court did not determine royalty obligations based upon market price at the time of the gas contract versus that price at the time of delivery of the gas.

116. *Middleton*, 613 S.W.2d at 245 (emphasis in original).

117. 217 Kan. 489, 537 P.2d 228 (1975). For the purposes of the court's decision, the parties agreed that the royalty clause apparently most common to the class would be applied to the controversy. *Id.* at ___, 537 P.2d at 231.

The royalty in dispute was to be calculated based upon the proceeds for gas sold at the well and based upon market value at the well for gas marketed off the leased premises. Thus, *Waechter* presented a similar dispute to that decided by the Texas Supreme Court in *Middleton*.¹¹⁸ The *Waechter* lessor argued a somewhat novel approach that the terms "proceeds" and "market value" as used in the disputed royalty clause were intended by the parties to refer to an arm's length sale in an unregulated field.¹¹⁹ However, the court noted that "'proceeds' was used only in context with the phrase 'if sold at the well,' while the term 'market value' was used in the alternative phrase 'or, if marketed by lessee off the leased premises'."¹²⁰ Thus, the court could find no ambiguity in the lease terms which would necessitate additional interpretation.¹²¹ In finding nothing particularly ambiguous in the terms "proceeds" and "market value", and expressly declining to rewrite the lease contract in favor of the lessor, the *Waechter* court exemplified a willingness to enforce an expression of proceeds, as opposed to market value, resulting in a benefit to the lessee.¹²²

118. See *supra* notes 110-16 and accompanying text.

119. *Waechter*, 217 Kan. at ___, 537 P.2d at 248. The lessor's argument with respect to the intent of the parties was as follows:

Appellees contend that when the royalty clause is considered as a whole it is clear the parties intended those terms to be synonymous—that they meant the same thing in terms of money. They say in the case of arms-length unregulated wellhead sale the market value of the gas would naturally equal the proceeds from a well-head sale. They further say that the 14.5¢ price fixed in the Shawnee County case is "the best evidence of the market value or price for the gas for the period in question and would result in the 'proceeds' contemplated by the parties, where mentioned in the lease."

Id. Thus, the lessor's argument appears to have been that the money actually received for the gas in question was not the proceeds within the meaning of the lease provision.

120. *Id.* at ___, 537 P.2d at 249.

121. The court held:

[T]he intent of the parties seems clear from the language used in the contract and there is no room for construction as urged. Nor do we see anything extrinsic in the case negating the parties' clearly expressed intent. They agreed the royalty should be one-eighth of the proceeds if sold at the well. We cannot make a new contract.

Id.

122. This approach had previously been adopted by a Kansas court in *Lippert v. Angle*, 211 Kan. 695, 508 P.2d 920 (1973), involving a dispute over a market value at the well royalty clause for gas sold from the lease premises. *Lippert* involved a lessee who was also the purchaser of the gas in question. *Id.* at ___, 508 P.2d at 922. The *Lippert* court rejected an argument that the lessee's contract to sell the gas to himself established a unique market, thereby providing market value based upon the lessee's division order/gas contract price. *Id.* at 926. *Lippert* established market value for the purposes of a royalty clause based upon current comparable sales. *Id.* Also, as in *Waechter*, the *Lippert* court rejected the lessor's argument that proceeds was equivalent to market value when such a construction would have resulted in a greater royalty payment to the lessor. *Id.* at 925.

2. *Lightcap v. Mobil Oil Corporation*

The Kansas Supreme Court demonstrated again, two years after *Waechter*, its resolve to enforce royalty provisions according to their express terms in *Lightcap v. Mobil Oil Corp.*¹²³ The case required construction of leases including market value and proceeds royalty clauses, as well as royalties based on the proceeds for sales at the well and market value for sales off the lease (which by now the court had dubbed *Waechter* leases).¹²⁴ While factually quite complex, the ruling of *Lightcap*, simply stated, is that a market value royalty is based upon the value which would be paid by a willing buyer to a willing seller in a free market.¹²⁵ Likewise, a proceeds type royalty was held to be discharged based upon the money obtained from the lessee's actual sale.¹²⁶ Of further significance was the Kansas court's failure to find any distinction between royalty clauses based upon market price and market value.¹²⁷

One important conceptual consideration which would arise in the yet to be decided *Tara*, absent from *Lightcap*, was a financially burdensome long-term gas purchase contract *vis-a-vis* the theoretical market

123. 221 Kan. 448, 562 P.2d 1 (1977), *cert. denied*, 434 U.S. 876 (1977). *Lightcap* contains an illuminating discussion of the relationship of a highly regulated gas market to the problems presented in construing market price leases. Beginning with an examination of *Weymouth v. Colorado Interstate Gas Co.*, 367 F.2d 84 (5th Cir. 1966), and *J.M. Huber Corp. v. Denman*, 367 F.2d 104 (5th Cir. 1966), the Kansas court traced a number of federal decisions, concluding with *FPC v. Texaco, Inc.*, 417 U.S. 380 (1974), where "market value" and "just and reasonable" rates for gas utility regulation were considered as two separate and distinct concepts. *Id.* at 395, 397-98. The court concluded that these federal cases stood for a rejection of the argument that the existence of a regulated ceiling price on gas establishes a maximum market value upon which a lessee's royalty obligation may be based. Instead, the cases were construed to require that royalties were to be determined under state law according to lease provisions, which royalties then become a component cost in determining permissible FPC rates. *Lightcap*, 221 Kan. at ___, 562 P.2d at 8. Any potential unfairness to the lessee was considered to be mitigated by the availability of individual rate relief, in the event royalty based on market value resulted in a lessee's costs being unusually high and in excess of those contemplated by the regulatory rate structure. *Id.* at 7-8. *See also* *Placid Oil Co. v. FPC*, 483 F.2d 880, 911 (5th Cir. 1973) (determination of royalty obligations of gas producers was a matter of state law beyond the control of the FPC), *aff'd sub nom.*, *Mobil Oil Corp. v. FPC*, 417 U.S. 283 (1974).

124. *Lightcap*, 221 Kan. at ___, 562 P.2d at 9.

125. It may fairly be suggested that any statement of the ruling is subject to attack as an oversimplification in that the seven ruling judges took four separate positions, which were then applied cumulatively as applicable to six distinct royalty provisions. Nonetheless, this synopsis of the ruling of *Lightcap* is accepted by most commentators. *See, e.g.*, WILLIAMS & MEYERS, *supra* note 4, § 650.4, at 650.37.

126. *Lightcap*, 221 Kan. at ___, 562 P.2d at 11.

127. For instance, one of the leases providing for royalty based on the market price at the well was categorized as a market value lease. *Id.* Thus, *Lightcap* is in accord with the majority of decisions which have not touched upon the possibility that some distinction between market price and market value exists. While the Oklahoma court in *Tara* does not reach a distinction, the ruling was limited to the construction of a market price clause, while a listing of other typical royalty clauses included market value along with proceeds. *Tara*, 630 P.2d at 1272 n.3.

value for the same gas.¹²⁸ The gas contracts in *Lightcap* provided for escalation based upon a "fair, just and reasonable" price for gas produced in the field.¹²⁹ Pursuant to these contracts, an escalation price was arbitrated by the lessee and its purchasers.¹³⁰ Thus, the difficulties alleged in *Tara* that the producer-lessee's revenues remained fixed although gas prices might fluctuate substantially was not a factor which the court needed to address in *Lightcap*.¹³¹

3. *Holmes v. Kewanee Oil Company*

The Kansas Supreme Court openly rejected the *Tara* rule, and the argument that a gas purchase contract price constitutes market price, in *Holmes v. Kewanee Oil Co.*¹³² The royalty clause construed in *Holmes* was based upon "gross proceeds at the prevailing market rate." A notable distinction between *Holmes* and *Tara* arose from the disputed leases having been executed subsequent to the gas purchase contracts.¹³³ Relying upon *Lightcap*, the *Holmes* court applied the now familiar comparable sales test in determining the royalty market value to be the highest price paid for comparable gas in the area.¹³⁴ Thus, the *Holmes* court in fact determined market value on the same basis that the Oklahoma court rejected in *Tara*—the highest available area price.

Of all the royalty clauses disputed and discussed in this Article, the *Holmes* royalty clause is arguably the most ambiguous because it em-

128. As previously discussed, the facts of *Tara* did not actually present such a long-term gas contract, see *supra* notes 42-47 and accompanying text; however, this industry practice obviously played an important role in the policy considerations of *Tara*. See *supra* notes 55-56, 61-62 and accompanying text.

129. *Lightcap*, 221 Kan. at ___, 562 P.2d at 4.

130. *Id.* No other evidence of market value was introduced in the *Lightcap* dispute, and the arbitrated gas contract price was accepted as the market value. *Id.*

131. The court cited *Lippert v. Angle*, 211 Kan. 695, 508 P.2d 920 (1973), in a reference which indicated that independent evidence of market value based upon the comparable sales standard of arm's length transactions would have constituted permissible proof of market value. *Lightcap*, 221 Kan. at ___, 562 P.2d at 5. See also *supra* note 122 for a discussion of the facts and holding in *Lippert*. The concept of a gas contract escalation clause based on a fair and reasonable price for the particular escalation might work to prevent a gross divergence between contract price and present market value if that fair and unreasonable price included elements such as present prevailing market value in the context of the selling lessee's royalty obligation. In light of recent developments which have led gas purchasers to seek to avoid paying their contract prices due to plummeting market values, it may be suggested that contract escalations based upon actual prevailing market value could have merit in protecting both sides to the gas contract from unexpected and detrimental effects of a fluctuating market.

132. 223 Kan. 544, 664 P.2d 1335 (1983).

133. *Id.* at ___, 664 P.2d at 1338.

134. *Id.* at 1341 (citing *Lightcap v. Mobil Oil Corp.*, 221 Kan. 448, 562 P.2d 1 (1977); *Exxon Corp. v. Middleton*, 613 S.W.2d 240 (Tex. 1981); *Texas Oil & Gas Corp. v. Vela*, 429 S.W.2d 866 (Tex. 1968); *Lippert v. Angle*, 211 Kan. 695, 508 P.2d 920 (1973)).

ployed both proceeds and prevailing market rate to describe the same royalty calculation.¹³⁵ Although the Kansas court did not label the royalty clause as ambiguous, the decision suggests the existence of ambiguity because the court applied a strict construction against the lessee, as well as noting the absence of evidence of intent to equate gas contract price and market value.¹³⁶

4. *Matzen v. Cities Service Oil Company*

Subsequent to the Oklahoma court's decision in *Tara*, the Kansas Supreme Court was presented with a similar dispute in *Matzen v. Cities Service Oil Co.*¹³⁷ Here, for the first time, all of the policy considerations presented by *Tara* were before the Kansas court. However, it does not appear that the *Tara* lessee's argument equating royalty market price and gas contract price was asserted in *Matzen*. This is perhaps understandable since the decision involved a class action determination requiring construction of both proceeds leases and market value leases.¹³⁸

Faithful to its earlier decisions, the *Matzen* court determined that proceeds leases were controlled by the gas contract price, and royalty under market value leases were held subject to the *Lightcap* rule—a price which would be paid by a willing buyer to a willing seller in a free market.¹³⁹ Applying the settled rule of evidence concerning comparable

135. A virtually identical royalty provision was considered by the Oklahoma Supreme Court in *Johnson v. Jernigan*, 475 P.2d 396, 397 (Okla. 1970), with respect to gas sold off the premises. The Oklahoma court determined that such a provision invoked the rate at which gas is commonly sold in the vicinity of the well, while noting that such a term implies the existence of a free and open market composed of willing sellers and buyers. *Id.* at 398. Notably, although the issues of *Tara* were not presented, the Oklahoma court, including Justice Lavender who issued the opinion in *Tara* and Justice Hodges who concurred in *Tara* and wrote the opinion in *Johnson*, ruled in the latter case: "The lessee is obligated to develop the commodity he has found so that it will bring the highest possible market value." *Id.* at 399. This would seem to impose a greater duty upon the lessee than that established by *Tara* in which the requirement was only that the lessee's contract be fair and reasonable, and representative of other contracts negotiated in the field at the same time. *Tara*, 630 P.2d at 1274.

136. *Holmes*, 223 Kan. at ___, 664 P.2d at 1342. The court does observe that the construction of the lease arose from the lessees having provided and dictated its terms. This rule should be considered as an aid in construction, and should be applied equally against the lessor in the event the lessor prepares the language giving rise to the dispute. See *infra* notes 237-39 and accompanying text.

137. 233 Kan. 846, 667 P.2d 337 (1983).

138. *Id.* at ___, 667 P.2d at 339.

139. *Id.* at 343-44. The *Matzen* decision was reached as a sequel to *Lightcap* in that *Lightcap* left unanswered the question of determination of free market value in a regulated market. Although the *Lightcap* court indicated that market value was subject to proof by any competent evidence, the parties offered no such evidence, resulting in the arbitrated gas contract price to be accepted as the market price. *Id.* at 342 (citing *Lightcap v. Mobil Oil Corp.*, 221 Kan. 448, 449, 562 P.2d 1, 4 (1977)).

sales,¹⁴⁰ the *Matzen* court upheld the trial court's determination of market value being the highest federal regulated price of new gas in the area. In so holding, the court recognized that evidence of federally regulated prices is probative in determining fair market value. It is particularly notable that the *Matzen* court specifically recognized the Oklahoma rule established in *Tara*, which it described as unpersuasive and insufficient to support an abandonment of the *Lightcap* rule.¹⁴¹

C. Interpretations Under Louisiana Law

1. *Wall v. United Gas Public Service Company*

The earliest reported case within the scope of this Article is the Louisiana Supreme Court decision in *Wall v. United Gas Public Service Co.*¹⁴² *Wall* involved a dispute over a gas royalty clause, seldom seen today, but which was common in the early days of gas production and marketing.¹⁴³ The lease provided for a fixed payment of \$200.00 per year for each well producing only gas. However, it was further provided that at such time as the gas was utilized or sold off the premises, the royalty would be calculated on the "value of such gas calculated at the market price."¹⁴⁴ The dispute arose when the lessee began transporting gas production through private pipelines for approximately two miles, at which point it was sold to an interstate pipeline company at 5.8¢ per Mcf. At the same time, the lessees were paying royalty based upon 4¢ per Mcf, an average market price in the field.¹⁴⁵ The Louisiana Supreme Court rejected the lessor's argument that, within the terms of the lease, market price meant the proceeds which the lessee received for gas sold off the premises.¹⁴⁶ Instead, the court determined that the evidence supported an average market price in the field of 4¢ per Mcf, and that the lessee's

140. *Id.* at 344-45. Nonetheless, the Kansas court did not go so far as to limit market value to a regulated ceiling price, a rule which has apparently been accepted in Louisiana. See *infra* notes 173-76 and accompanying text.

141. *Id.* at 344. Included with *Tara* in this rejection was the Arkansas decision of *Hillard v. Stephens*, 276 Ark. 545, 637 S.W.2d 581 (1982), discussed *infra* notes 179-90 and accompanying text; and the Louisiana case of *Henry v. Ballard & Cordell Corp.*, 418 So. 2d 1334 (La. 1982), discussed *infra* notes 161-69 and accompanying text.

142. 178 La. 908, 152 So. 561 (1934).

143. With gas having been considered as having little value as a marketable commodity in the early days of the oil and gas industry, royalty clauses had not yet been developed to take into consideration a royalty obligation calculated upon the lessee's marketing of the lessor's fractional share of gas production. See KUNTZ, *supra* note 8, § 40.2.

144. *Wall*, 178 La. at ___, 152 So. at 562.

145. *Id.*

146. *Id.* at 563.

royalty obligation was to be satisfied based upon this price.¹⁴⁷

The *Wall* court apparently deemed the royalty provision ambiguous,¹⁴⁸ and found nothing in the lease nor in the evidence which would indicate the intent of the parties in using the term "market price". To resolve the matter, the court relied upon Louisiana law that gas is reduced to ownership at the well head.¹⁴⁹ Therefore, the court reasoned that where gas is to be divided in kind, the division of the proceeds or value should occur at the point and time of vesting of ownership—in other words, at the well head.¹⁵⁰ As a result, the court found it reasonable that the parties had intended the royalty to be calculated upon current market price in the field.¹⁵¹ This conclusion was further supported by the adoption of various definitions of market price, all of which embraced a concept of current market transactions.¹⁵²

Perhaps the most intriguing aspect of *Wall* is the extent to which the facts constituted a reverse image of those presented in *Tara*. In *Wall*, the lessor found itself arguing, to no avail, that "market price" meant proceeds, as opposed to the lessor's argument in *Tara* that "market price" was the equivalent of the current market price in the field. In light of the volatile nature of the gas market, it is certainly conceivable that an Oklahoma court could be faced with a circumstance similar to that presented in *Wall*. Thus, it is interesting to speculate whether an Oklahoma lessee with a market price royalty clause would be required to

147. *Id.* The court relied upon the following definition of "market price":

The actual price at which a given commodity is *currently sold*, or has recently been sold, in the open market, that is, not at forced sale, but in the usual and ordinary course of trade and competition, between sellers and buyers actually free to bargain, as established by records of latest sales.

Id. (quoting BLACK'S LAW DICTIONARY) (emphasis in original).

148. *Id.* at 564-65. There was no specific ruling of ambiguity in the decision, and the court's inquiry was not based upon any suggestion that market price meant anything other than its commonly accepted meaning. *Id.* at 563. The court pointedly noted that "market price" does not mean an arbitrary price fixed by the lessee." *Id.* Instead, the attempt to define the intent of the parties focused upon whether market price was to be determined at the well or at a remote market. *Id.*

149. *Id.*

150. *Id.* Arkansas, which followed *Tara* in one decision, followed a rule, contrary to that reached in *Wall*, that a lease constitutes a present sale of gas in place at the time the lease is entered into. See *Hillard v. Stephens*, 276 Ark. 545, ___, 637 S.W.2d 581, 583 (1982); see also *infra* notes 179-90 and accompanying text for further discussion of *Hillard*. The trial court in *Wall* had held the royalty obligation to be based on the lessee's proceeds at a market removed from the leased premises and less the expense of transporting the gas. *Wall*, 178 La. at ___, 152 So. at 563. This ruling was rejected by the Louisiana Supreme Court on the basis of evidence which indicated that a market value did in fact exist in the field, upon which the court based the royalty calculation in accordance with its determination of the intent of the parties to the disputed lease. *Wall*, 178 La. at ___, 152 So. at 564-65.

151. *Id.* at 563-64.

152. *Id.*

pay royalty based upon his proceeds where the market price in the field had plummeted far below his gas contract price.¹⁵³

2. *Sartor v. United Gas Public Service Company*

Three years after *Wall*, the Louisiana Supreme Court was confronted, in *Sartor v. United Gas Public Service Co.*,¹⁵⁴ with a dispute over a royalty clause based upon the value of gas used or sold off the premises. Neither party disputed that the royalty owners were entitled to payments based upon market value. The court, therefore, applied the definition of market value, which it had previously established in *Wall*, as the current market price paid at the well or in the field.¹⁵⁵ The court went further, however, and, citing an earlier decision,¹⁵⁶ stated that such market price lease clauses are clear from ambiguity and doubt.¹⁵⁷

In addition to the royalty based upon the current market price at the well or in the field, the lessors sought increased royalty based upon the lessee's gas pipeline contract prices.¹⁵⁸ In rejecting this argument, the court observed that the evidence of market value introduced at the trial clearly supported the lessee's allegations of market value in the field.¹⁵⁹ Like *Wall*, the decision in *Sartor* relied heavily upon market conditions under which the lessee was able to obtain very favorable pipeline gas

153. Of course, so long as the gas purchaser continued to honor its contract price, the lessee would be placed in no difficulty and could continue to pay royalties on the basis of such proceeds. In fact, however, the market price for gas in Oklahoma fields has, in many instances, currently fallen below the price terms of some long-term gas contracts entered into at a time when prevailing prices were substantially higher than at the present time. As such, sellers of gas are currently being pressured to renegotiate their contracts, with the purchaser frequently relying upon the force majeure clause of its contract to justify failure to continue to pay at the contract rate. Conversation February 26, 1985, with Mr. James R. Eagleton, Senior Partner, Houston and Klein, Inc., and current president, Oklahoma Bar Association. Mr. Eagleton has practiced as a Tulsa trial attorney in oil and gas litigation for over 35 years, and successfully represented a Creek County farmer in a royalty dispute in *Olansen v. Texaco, Inc.*, 587 P.2d 976 (Okla. 1978). For a discussion of this case, see *supra* note 34. In the absence of express language in a force majeure clause to include market price fluctuation, however, courts have generally not been willing to excuse financially burdensome performance based upon the traditional concept of force majeure as an unforeseeable condition beyond the control of the performing party. See, e.g., *Neal-Cooper Grain Co. v. Texas Gulf Sulphur Co.*, 508 F.2d 283 (7th Cir. 1974).

154. 186 La. 555, 173 So. 103 (1937).

155. See *supra* notes 146-52 and accompanying text.

156. *Sartor v. United Carbon Co.*, 183 La. 287, 163 So. 103 (1935).

157. *Sartor*, 186 La. at ___, 173 So. at 105. Interestingly, the court also cited *Wall* in support of this proposition, in spite of indications in *Wall* that the lease language may have been subject to construction with respect to the intent of the parties had evidence of record existed to justify defining market value in a sense other than its commonly understood and accepted meaning. *Wall*, 178 La. at ___, 152 So. at 563.

158. *Sartor*, 186 La. at ___, 173 So. at 106.

159. *Id.*

contract prices in exchange for accepting certain onerous burdens from those same contracts.¹⁶⁰

3. *Henry v. Ballard & Cordell Corporation*

In 1982, the Louisiana Supreme Court decided *Henry v. Ballard & Cordell Corp.*,¹⁶¹ which has been characterized as an adoption of the same rule set out by the Oklahoma court in *Tara*.¹⁶² This dispute involved four leases, all of which provided for royalty based upon market value for gas sold off the lease, and two of which further provided for royalty based upon proceeds for gas sold at the well.

While the lessors relied upon the court's earlier decision in *Wall*, the *Henry* court treated *Wall* as factually distinctive¹⁶³ although, on the narrow issue of lease language interpretation, the two cases stand for absolutely contrary positions. While *Wall* held market value to mean current market value,¹⁶⁴ the *Henry* court treated the royalty clauses as subject to an ambiguity arising from their failure to state expressly whether market value meant current market value.¹⁶⁵

In resolving the problem, the *Louisiana* court discussed at length many of the same policy considerations underlying the rule of *Tara*.¹⁶⁶

160. *Id.* at 106-07. These burdens included the risk that the wells would continue to produce during the term of the contract, and the potential for the necessity of drilling additional wells to cover the demand gas contract in the event of failure of current production. *Id.* at 107. This potential arguably implies that the contract was not conditional upon adequate production from existing wells to fulfill the contract requirements. One recent decision, applying the Uniform Commercial Code to the sale of gas, may support the proposition that the failure of production from wells could excuse performance under the concept of impracticability if the exhaustion of production is not the seller's fault, was not foreseeable at the time of contracting, and was not assumed by the seller as a risk of the agreement. *Sunflower Elec. Coop. v. Tomlinson Oil Co.*, 7 Kan. App. 2d 131, —, 638 P.2d 963, 969 (1981).

161. 418 So. 2d 1334 (La. 1982).

162. See *Lowe, Eastern Oil and Gas Operations*, *supra* note 4, § 20.03[2], at 20-32. Cf. *supra* note 141 and accompanying text.

163. The dispute in *Wall* was said to have centered upon the place of the determination of market price, whether in the field or at a more remote market. 418 So. 2d at 1336.

164. See *supra* notes 146-52 and accompanying text.

165. *Henry*, 418 So. 2d at 1337. See *supra* note 157 and accompanying text for a previous determination by a Louisiana court that market value is a clear and unambiguous term. Even though *Henry* refers to the *Wall* court's citations of common definitions of market value as dicta, *id.* at 1336, those same definitions have been applied repeatedly in controversy over this issue.

166. *Id.* at 1338-39. It is worth noting that the purchaser was determined to be the only available market at the time the gas contract was executed. *Id.* at 1336. The same was true in *Texas Oil & Gas Corp. v. Vela*, 429 S.W.2d 866 (Tex. 1968, no writ). For a discussion of the *Vela* decision, see *supra* notes 101-09 and accompanying text. The Texas court in *Vela* was uninfluenced by the unavailability of a market subsequent to the execution of the lease and this condition was not deemed relevant to the intent of the parties at the time the lease was negotiated. *Id.* at 870-71. See also *supra* note 107. To the contrary, the Louisiana court in *Henry* seemed greatly concerned with construing the lease based upon such subsequent market circumstances. *Henry*, 418 So. 2d at 1338-39. Two of

A careful reading of the decision does not, however, support an adoption of lease construction such as was reached in *Tara* as a matter of law. Unlike the court in *Tara*, the *Henry* court, having determined the royalty clause to be ambiguous, indicated the propriety of considering extrinsic evidence to determine the intent of the parties.¹⁶⁷ Nonetheless, only the lessees had presented any evidence that the parties had intended to fix the market price at the time gas was committed to a sales contract.¹⁶⁸ Consequently, the court observed that a different conclusion may have resulted had the lessors proved that the parties had intended the royalty clause to operate independently of the lessee's actual disposition of the production.¹⁶⁹

Henry is a difficult case from which to draw general conclusions in that the decision clearly revolved around extrinsic evidence of the intent of the parties in entering into a particular lease. To this extent, the case certainly cannot be criticized as subject to the same unfair assumptions as were made by the Oklahoma court in *Tara*.

4. *Shell Oil Company v. Williams, Inc.*

The latest Louisiana Supreme Court decision construing a market value royalty clause, *Shell Oil Co. v. Williams, Inc.*,¹⁷⁰ like the 1982 *Henry* decision, falls far short of expressly adopting the *Tara* rule. In fact, *Shell Oil* does not even involve a proceeds versus market value royalty clause.¹⁷¹ Two lease clauses were at issue, one providing for the value of royalty gas calculated at the market rate prevailing at the well, and the second providing for value calculated at the market price prevail-

the *Henry* leases pre-dated the 1961 gas contract while another was dated 1962 and a fourth, 1964. *Id.* at 1335. The court referred to the leases having begun production in 1961 without further explanation. 418 So. 2d at 1335, 1340.

167. *Id.* at 1340-41. *Cf. supra* notes 52-53 and accompanying text.

168. The court observed:

We do not propose to penalize defendants' good faith compliance with their lease obligations by requiring them to pay royalties based on a current, fluctuating, day-to-day market value of gas several times higher than the price received by them in a sales contract admittedly in the best interest of both lessors and lessees. Had plaintiffs shown that the purpose of the market value royalty clause was to provide them with protection as to price, regardless of what disposition is made of the gas by lessee and regardless of what price was received, then we would arrive at a different conclusion.

Id. at 1340.

169. *Id.* One concurring opinion of *Henry* further supports a reading of the case as failing to establish a rule that all parties to market value leases will be deemed to have intended that term to be synonymous to the gas contract proceeds but constituting only a determination of the intent of these particular parties based upon the evidence. 418 So. 2d at 1341 (Calogero, J., concurring).

170. 428 So. 2d 798 (La. 1983).

171. *Id.* at 799.

ing at the well.¹⁷²

These expressions of market value, by stipulation of the parties and by evidence of record, were determined to refer to current market value.¹⁷³ However, the lessor contended the current value to mean the current price on the open, unregulated market at the time of production. The lessee, on the other hand, argued that because the gas had been irrevocably committed to an interstate market, the only comparable sales for market value were those in the interstate market.¹⁷⁴ The Louisiana court¹⁷⁵ sided with the lessee, determining that comparable sales for evidence of market value must reflect the legal characteristic of whether the gas is sold on a regulated or unregulated market.¹⁷⁶

This decision again, as in *Henry*, makes operative the express intent of the parties regarding the definition of market value.¹⁷⁷ *Shell Oil*, as with the other Louisiana cases discussed here, appears to reach a proper decision based on the individual facts and circumstances. Nonetheless, *Shell Oil* adopts a rule of proof unfavorable to lessors whereas *Henry* has been cited as adopting the rule of *Tara*.¹⁷⁸

D. Interpretations Under Arkansas Law

1. *Hillard v. Stephens*

The Arkansas Supreme Court, in *Hillard v. Stephens*,¹⁷⁹ considered

172. *Id.* at 799-800. Since neither party asserted an ambiguity, this case does not throw any light on conflicting decisions by the Louisiana court on this issue. See *supra* notes 148-52, 155-57 and accompanying text. However, the *Shell Oil* court, in considering whether the parties intended that the amount of the royalty might vary in accordance with price regulations, did expressly state that the lease provision in question was not ambiguous. *Id.* at 803 (citing *California v. Southland Royalty Co.*, 436 U.S. 519 (1978), *reh'g denied*, 439 U.S. 885 (1978)).

173. *Shell Oil*, 428 So. 2d at 799.

174. *Id.* at 802 (citing *Kingery v. Continental Oil Co.*, 626 F.2d 1261 (5th Cir. 1980), *cert. denied*, 454 U.S. 1148 (1982); *First Nat'l Bank v. Exxon Corp.*, 622 S.W.2d 80 (Tex. 1981, no writ)).

175. *Cf. Matzen v. Cities Serv. Oil Co.*, 233 Kan. 846, ___, 667 P.2d 337, 344-45 (1983) (market value is determined based on highest federal regulated price). See generally *supra* notes 137-41 and accompanying text.

176. *Shell Oil*, 428 So. 2d at 802. This decision, construing rights and obligations of the owner of gas with respect to the FPC, does not appear to support the rule that subsequent federal regulation of gas may be a basis for altering what has otherwise been accepted as unambiguous lease language.

177. *Id.* at 803. Still, the court's construction of the method of proof of market value supported the lessee's position and determined the applicable market for comparable sales with respect to conditions arising after the lease was entered into.

178. See, e.g., Lowe, *Developments in Non-regulatory Oil and Gas Law: Issues of the Eighties*, *supra* note 4, at 6.

179. 276 Ark. 545, 637 S.W.2d 581 (1982). The result of this decision is particularly questionable as supportive of the *Tara* rule since the disputed lease initially provided for royalty at the rate of five cents per one thousand cubic feet. The phrase five cents was stricken out and the words "pre-

the construction of a royalty clause based upon the value of gas sold off the premises at the prevailing¹⁸⁰ market rate at the well. The lessor sought a royalty computed on a daily basis¹⁸¹ of the current market value in the field. The lessee assumed the *Tara* producer's position that the prevailing market price at the well was determined by its gas contract price.

The Arkansas court accepted the lessee's argument in full. Relying heavily upon the ruling in *Tara*, the court emphasized the lessee's duty to market and the economic necessity of entering into long-term gas purchase contracts.¹⁸² Based on these considerations, the court held "prevailing market price at the well" to mean a market price based upon the producer's gas contract price.¹⁸³ Further, such an interpretation was inferred to be "consistent with the intent and understanding" of the parties involved.¹⁸⁴ Similarly, as in *Tara*,¹⁸⁵ the *Hillard* court limited its ruling to situations in which the gas purchase contract was fair and reasonable when entered into in light of other contracts negotiated at the time in the field.¹⁸⁶

It is worth noting that the court's ruling in favor of the lessee began with a ruling that a "gas lease constitutes a present sale of all of the gas in place at the time such lease is executed . . ." ¹⁸⁷ This is not the law of

vailing market price at well" inserted. *Id.* at ___, 637 S.W.2d at 582. The language, therefore, did not result from the use of a printed form but was deliberately inserted by the parties. Under these circumstances, the trial court ruled that the term market price should be considered in its common and ordinary sense. *Id.* at 586. If, as the appeals court found, the disputed language was ambiguous, then a factual question of intent arose. A remand to determine the factual issue would have been appropriate since the opinion indicated an abundance of testimony which was not considered because of the trial court's finding of a clear meaning from the express language used. *Id.* at 586 (Hickman, J., concurring in part and dissenting in part). In fact, the decision recites evidence indicating that it was the lessee that prepared the lease with the altered language providing for market price, and also that the lessee was familiar with the use of proceeds leases. *Id.* at 587.

180. An additional basis for questioning the results of this case is the express use of the term "prevailing" as modifying market rate. Such language is not as precise as the provisions for "prevailing rate in the field when run" found in the early Texas decision of *Foster v. Atlantic Ref. Co.*, 329 F.2d 485 (5th Cir. 1964). For a discussion of the *Foster* decision, see *supra* notes 85-92 and accompanying text. Still, a construction that the provision was intended to refer solely to the gas contract price as established at a fixed rate strains the logical and reasonable meaning of the term "prevailing" quite beyond reason.

181. *Hillard*, 276 Ark. at ___, 637 S.W.2d at 583.

182. *Id.* at 584-85 (quoting *Tara Petroleum Corp. v. Hughey*, 630 P.2d 1269, 1273 (Okla. 1981).

183. *Id.* at 585.

184. *Id.*

185. *Tara*, 630 P.2d at 1274.

186. *Hillard*, 276 Ark. at ___, 637 S.W.2d at 585. It should be noted that, unlike in *Tara*, there was evidence of a substantial number of gas contracts in the area. *Id.* at 584; *cf. Tara*, 630 P.2d at 1274, and *supra* note 60 and accompanying text.

187. *Hillard*, 276 Ark. at ___, 637 S.W.2d at 583.

Oklahoma;¹⁸⁸ however, this concept does not appear critical in the ruling in *Hillard*. Thus, beyond its initial discussion of the basic nature of oil and gas leases, the Arkansas court expressly cites *Tara*, and clearly adopts the same rule on the same grounds.¹⁸⁹

2. *Diamond Shamrock Corporation v. Harris*

The Arkansas court's decision on *Hillard*, standing alone, clearly embraces the *Tara* rule in its entirety. However, the Arkansas Supreme Court in late 1984 decided *Diamond Shamrock Corporation v. Harris*,¹⁹⁰ which casts considerable doubt over the stance the Arkansas court will take on this question in the future.

In *Diamond Shamrock*, the lease in question was entered into July 1, 1977, at which time the lessee Diamond Shamrock was already a party to a long-term gas purchase contract with Arkla, Inc., dated December 7, 1971. This contract covered all production by Diamond Shamrock from wells in an area including the acreage leased from Harris. The Harris lease provided for gas royalty based upon market value at the well for production sold or used off the premises, and based upon proceeds from gas sales at the well.¹⁹¹ The lessee argued that market value for gas produced from the Harris lease was established by the 1971 Arkla contract. Harris sought to recover royalties based on market value. The Arkansas Supreme Court affirmed the trial court's ruling that Harris was entitled to royalty based upon market value, the best evidence of which was determined to be the price paid other participants in the same well.¹⁹²

In support of its ruling, the Arkansas court pointed out that it

188. An oil and gas lease under Oklahoma law "does not operate as a conveyance of any oil or gas *in situ* but constitutes merely a right to search for and reduce to possession such of these substances as might be found." *Hinds v. Phillips Petroleum Co.*, 591 P.2d 697, 698 (Okla. 1979).

189. With respect to its ruling, the court held:

[I]t is the only interpretation that operates fairly for the producer. It is not unfair to the [lessees]. As long as the gas purchase contracts were reasonable when entered into, and as long as the law recognizes long-term gas purchase contracts as binding in the face of escalating prices, the law should not penalize [the producer] who was forced into the gas purchase contracts in a large measure by its duty to the [lessees] to market the gas efficiently and effectively.

Hillard, 276 Ark. at ___, 637 S.W.2d at 585.

190. ___ Ark. ___, 681 S.W.2d 317 (1984).

191. ___ Ark. at ___, 681 S.W.2d at 319. The dissenting opinion would have granted the lessor royalty based on proceeds by finding that the gas production in question was sold at the well, and applying the plain wording of the lease. *Id.* at 321 (Hubbell, J., dissenting). This question is not addressed by the majority opinion, and no facts sufficient to determine this issue appear in the reported text.

192. ___ Ark. at ___, 681 S.W.2d at 319. No authority is cited; however, such a finding clearly relies in some measure upon the concept of comparable sales for determination of market value.

would be unfair to hold the lessor to a gas contract price which the lessor was neither aware of nor a party to.¹⁹³ This willingness to view the oil and gas lease and the producer's sales contract as separate instruments, without common parties, is a clear rejection of the *Tara* approach. *Diamond Shamrock* further retreats from *Hillard* by suggesting a construction of the lease against Diamond Shamrock, the party that drafted the instrument.¹⁹⁴ It is quite curious that *Diamond Shamrock* makes no reference to the earlier *Hillard* decision; therefore, any hard and fast conclusion regarding the approach the Arkansas courts will take on this question in the future would, at best, be premature. Nonetheless, this decision once again leaves Oklahoma the only jurisdiction which has not approached this problem on an *ad hoc* basis, without regard for the actual intent of the parties to the lease.

E. Interpretations Under Mississippi Law

Piney Woods Country Life School v. Shell Oil Company

As clearly as the Arkansas court initially embraced *Tara* in *Hillard v. Stephens*, the Oklahoma rule was rejected by the United States Court of Appeals for the Fifth Circuit, applying Mississippi law, in *Piney Woods Country Life School v. Shell Oil Co.*¹⁹⁵ The disputed royalty clauses provided for royalty based upon market value for gas sold or used off the premises and based upon proceeds for gas sold at the well.¹⁹⁶ After finding the gas was not sold at the well within the meaning of the leases, the *Piney Woods* court embarked upon an extensive, well-reasoned, and well-supported decision of the meaning of market value as used in these royalty provisions.¹⁹⁷

193. *Id.* at 321.

194. *Id.*

195. 726 F.2d 225 (5th Cir. 1984).

196. *Id.* at 228.

197. The court referred to earlier problems having been subject to perceived grammatical ambiguities. *Id.* at 230 (citing *Exxon Corp. v. Middleton*, 630 S.W.2d 240 (Tex. 1981); Note, *Henry v. Ballard & Cordell Corp.: Louisiana Chooses a Point In Time In the Market Value Gas Royalty Controversy*, 43 LA. L. REV. 1257 (1983)). Such ambiguities were apparently perceived by the *Piney Woods* court as well because extrinsic evidence and rules of construction were employed to construe the royalty provisions. *Piney Woods*, 726 F.2d at 233-38. For example, the court ruled:

But our decision that market value means value rather than proceeds is not simply an instance of interpretation against the lessee. It is rather a holding that, although the royalty clauses might have been less than lucid to laymen, they were quite readily understandable to those in the industry. Shell knew what a "market value" lease was and what a "proceeds" lease was. . . . Shell "cannot expect the court to rewrite the lease to [its] satisfaction".

Id. at 236 (citing *Hillard v. Stephens*, 276 Ark. 545, ___, 637 S.W.2d 581, 587 (1982); *Lightcap v. Mobil Oil Corp.*, 221 Kan. 448, 457, 562 P.2d 1, 8 (1977)).

The Fifth Circuit, rejecting the lessee's *Tara* type argument,¹⁹⁸ noted the uninterrupted line of authority upholding what the court referred to as the "*Vela* rule" which states that market value refers to value at the time of production and delivery rather than the time when the gas sales contract was entered into.¹⁹⁹ The court elected to follow the *Vela* rule based in part upon its determination that gas is not sold under a gas contract until produced.²⁰⁰ Therefore, market value was held to refer to the value at the time of production rather than at the time of execution of the gas contract. The Fifth Circuit court went further, however, and noted that the leases distinguished between gas sold at the well and gas sold off the lease and between amount realized and market value. The basis for the royalty must, therefore, be determined at the time of production and delivery, not at the time a gas purchase contract is entered into.²⁰¹ In finding this distinction significant when determining the intent of the parties, the court declared that the *Tara* rule eliminated any distinction between market value and amount realized, purportedly justified by the requirement that gas contracts be made prudently and in good faith.²⁰² However, this limitation to *Tara* was viewed as "illusory" by the *Piney Woods* court since the duties to deal in good faith and to market the gas also exist under a proceeds lease.²⁰³ As a result, the lessor would not be bound to a lessee's contract price made in bad faith.²⁰⁴

The court further rejected the interpretation advanced by leading commentators that market value may never exceed actual proceeds.²⁰⁵ It

198. *Id.* at 237.

199. *Id.* at 233 (citing *Foster v. Atlantic Ref. Co.*, 329 F.2d 485 (5th Cir. 1964); *Lightcap v. Mobil Oil Corp.*, 221 Kan. 448, 562 P.2d 1 (1977), *cert. denied*, 434 U.S. 876 (1977); *Wall v. United Gas Public Serv. Co.*, 178 La. 908, 152 So. 561 (1934); *Montana Power Co. v. Kravik*, 179 Mont. 87, 586 P.2d 298 (1978); *Exxon Corp. v. Middleton*, 613 S.W.2d 240 (Tex. 1981), *rev'd and remanded*, (1981, dismissed per stipulation); *Texas Oil & Gas Corp. v. Vela*, 429 S.W.2d 866 (Tex. 1968, no writ)).

200. *Piney Woods*, 726 F.2d at 234. Applying the Mississippi Uniform Commercial Code, the court determined that gas under ground should be considered as future goods, *id.* (citing MISS. CODE ANN. STAT. § 75-2-105 (1972)), and thus not a transfer of an interest in land. The court found that gas purchase contracts are described by the UCC as a contract to sale, rather than a sale (citing MISS. CODE ANN. § 75-2-107(1) (1972)). Oklahoma's statutes are identical. *See* OKLA. STAT. tit. 12A, §§ 2-105(1), 2-107(1) (1984). In applying the traditional definition of market value as reflected in evidence of comparable sales, the *Piney Woods* court concluded that such sales must necessarily reflect market conditions at the time of production and delivery of the gas. 726 F.2d at 235.

201. 726 F.2d at 235.

202. *Id.* The court in *Piney Woods* could not accept this reasoning employed in *Tara* when the lease before it distinguished between royalties based on the amount realized and those based on market value. *Id.*

203. *Id.*

204. *Id.* (citing *Kretni Dev. Co. v. Consolidated Oil Corp.*, 74 F.2d 497, 500 (10th Cir. 1934)).

205. *Id.* (citing *Harmon, Gas Royalty—Vela, Middleton, and Weatherford*, 33 INST. ON OIL &

is certainly true that the parties to a lease may so limit royalties but have no obstacle in agreeing to a lease wherein the market value may in fact exceed proceeds.²⁰⁶ So noting, the court observed that the dispute before it involved printed lease forms provided by the lessee which could easily have provided for a proceeds basis had that been the true intent of the parties.²⁰⁷ While the *Piney Woods* court engaged in some discussion of the relative bargaining position between the parties, its decision would have been better justified by the simple rule that an ambiguity will be construed most strictly against the party responsible for it.²⁰⁸ If the lessee chose to use a printed form lease which raised an ambiguity, it should not be permitted to complain later that the court's construction goes against it.²⁰⁹

The *Piney Woods* court also examined industry practices as an aid to construction, elements of which are found in *Tara*.²¹⁰ The lessee argued that payment of royalties on proceeds had always been the custom in Mississippi. The court, however, found no basis that such a custom existed. Additionally, the lessor was not found to have had any understanding of such a custom, the existence of which would have resulted from royalty payments calculated by the lessee in a fashion obscure to

GAS. L. & TAX'N 65, 69 (1982); Lowe, *Developments in Non-regulatory Oil and Gas Law*, 32 INST. ON OIL & GAS L. & TAX'N 117, 146-47 (1981)).

206. Any such obstacle imposed by judicial construction of the parties' contract would, however, destroy the expectation interest of the parties in accepting the risks in exchange for possible benefits of a fluctuating market.

207. *Piney Woods*, 726 F.2d at 235. The court noted further that "Shell and other lessees plainly knew how to draft a proceeds lease." *Id.* n.12.

208. *Id.* at 235 (citing *Frost v. Gulf Oil Corp.*, 238 Miss. 775, 786, 119 So. 2d 759, 761 (1960); 2 W. SUMMERS, LAW OF OIL & GAS § 232 (perm. ed. 1959); 3 H. WILLIAMS, OIL AND GAS LAW § 628 (1981)).

209. The court's discussion of this rule of construction which it describes as an established doctrine, including its continued viability in Oklahoma, 726 F.2d at 235 n.13 (citing Waldman, *The Demise of Automatic Termination*, 54 OKLA. B.J. 2767, 2773 (1983)), is instructive but unnecessary to the court's decision. However, in as much as the rules of construction dictated the same result ultimately rendered in *Piney Woods*, it is clear that the court determined the plain meaning of the lease language in the context of the purpose of the royalty clause in its entirety. *Id.* at 230.

210. The Fifth Circuit's decision goes beyond the customs of long-term gas contracts, further examining contingents that royalties based on good faith contract prices had always been industry custom in Mississippi. 726 F.2d at 236. The court also expressed reservations about the universality of this custom, citing *Shell Oil Co. v. Williams, Inc.*, 428 So. 2d 798, 799 (La. 1983), wherein this same lessee, Shell Oil Company, stipulated that market value royalty is determined by current market value. 726 F.2d at 236. The court further observed that such a stipulation is significant, not because of any binding effect in the litigation, but as relevant to industry custom. *Id.* Relevant custom is only that known to both parties. The court did not find any indication that lessors would have had any way of knowing, and would, therefore, not be presumed to know that a lessee made a practice of making royalty payments under market value leases at something other than current value. *Id.*

the lessor.²¹¹

The court disassembled and rejected the policy arguments and purported fairness to both parties, relied upon by the *Tara* court,²¹² and rejected as an intervention "on behalf of producers experienced in the petroleum industry, and thereby depriv[ing] lessors of their legitimate contractual expectations."²¹³ Instead, the *Piney Woods* decision recognized those arguments as an attempt to relieve a party to a contract of performance which had become burdensome.²¹⁴ Finally, the court observed that the *Tara* rule, in addition to depriving the lessor of its expected market value royalty, also removes any incentive to renegotiate the lease to reflect current economic circumstances.²¹⁵ The Fifth Circuit appropriately characterized such an approach as judicial law-making, without regard to the intent of the parties, in rewriting the lease to the satisfaction of the lessee.²¹⁶

IV. COMMENTS, CRITICISMS, AND SUGGESTIONS

The judicial construction of any disputed royalty clause must focus on the particular language before the court. Formulation of general rules, such as the *Tara* holding that a market price lease and a proceeds lease are equivalent in the presence of a fair and reasonable subsequent long-term gas contract, does very little to advance the function of the court—enforcement of the rights of the parties as provided by written contract. The courts must deal with the individual language involved in accordance with established principles of law and refrain from broad

211. Oklahoma case law supports the proposition that a knowledgeable party who knows or should know that the other party to his contract is using a term in its ordinary sense may not fail to disclose any special meaning which the other intends. *See, e.g., CMI Corp. v. Gurries*, 674 F.2d 821, 824 (10th Cir. 1982) (quoting OKLA. STAT. tit. 15, § 161 (1984)).

212. *Piney Woods*, 726 F.2d at 237.

213. *Id.* (citing *Foster v. Atlantic Ref. Co.*, 329 F.2d 485, 490 (5th Cir. 1964)). The court elaborated noting that the role of the court is not to establish whether suffering an assumed risk is fair, that assumption being a bargained for element of the agreement. *Id.*

214. 726 F.2d at 237.

215. *Id.* at 237-38. The court concluded: "By enforcing the clear terms of the market value lease, we preserve those expectations and provide opportunities and incentives for the parties to make new contracts more nearly reflecting current economic conditions." *Id.* at 238. Even in enforcing the plain terms of the lease, the court recognized that performance may become so burdensome to the lessee that economics would dictate an abandonment of the lease. *Id.* at 237. However, a counterbalancing incentive is seen for the lessor to renegotiate to assure uninterrupted payment of royalty from a present lessee who can continue production with existing lease facilities. *Id.* In as much as the dispute arose from an excess of the market value over the existing gas contract price, the lessee's purchaser may also have been induced to renegotiate than to seek different and more plentiful gas sources. *Id.*

216. 726 F.2d at 237.

generalizations based on the court's notion of what may or may not be fair.²¹⁷ With respect to the subject matter of a wholly integrated contract, contracting parties have only such rights as their written agreement, supplemented by established legal principles, gives them.²¹⁸ Contracts which fix obligations and are to be performed within the confines of a fluctuating market impose risks upon and grant expectations to the parties.²¹⁹ The fact that one party's risk has become a loss, thereby ripening into the other party's expected benefit, is simply not a matter of judicial concern. If performance of an agreement becomes so economically oppressive as to be impracticable or impossible, established legal principles exist for determining the rights of the parties.²²⁰ Those principles do not, however, include the rewriting of contract language to reflect what the court believes the parties might have agreed upon had it occurred to them that the market would so drastically change, or had they the benefit of hindsight in the market place.²²¹

The threshold question in enforcing a royalty lease clause is whether

217. The harshness of an agreement which, if enforced, imposes only the detriment of a risk voluntarily assumed in the bargaining has never been an acceptable basis under Oklahoma law for judicial modification of the agreement. See *Bankers Reserve Life Co. v. Rice*, 99 Okla. 184, 187, 226 P. 324, 326 (1924). In the context of this Article, this assumes the propriety of determining the definition of market price or market value to be clear and without need of construction by resort to extrinsic evidence. On the other hand, excessive harshness is an acceptable consideration in construing an ambiguous term to the extent that such an ambiguity will not be resolved so as to result in oppression or gross inequity. See *Federal Land Bank v. Nicholson*, 207 Okla. 512, 514, 251 P.2d 490, 493 (1952).

218. Again, the existence of an ambiguity will determine whether or not the burdens and benefits of a written agreement will be subject to examination in light of extrinsic evidence. Absent such uncertainty, the common and ordinary sense of the language used must be enforced. See *Martin v. Harper*, 208 Okla. 303, 304, 255 P.2d 943, 945 (1953).

219. See *supra* notes 204-12 and accompanying text.

220. Oklahoma has accepted commercial impracticability as an excuse for nonperformance with respect to sales of goods. See OKLA. STAT. tit. 12A, § 2-615 (1984). However, oil and gas leases are not subject to the UCC in Oklahoma. See *Casper v. Neubert*, 489 F.2d 543, 546 (10th Cir. 1973) (applying OKLA. STAT. tit. 12A, § 2-105(1) (1984)). Still, other jurisdictions have softened the harsh common law requirement of absolute physical impossibility, by analogy, to the commercial impracticability concept of the UCC in order that the concept can be applied to oil and gas leases. See *Sirianni, The Developing Law of Contractual Impracticability and Impossibility: Part I*, 14 U.C.C. L.J. 30 (1981-82). Additionally, the UCC has been applied in more than one jurisdiction to a gas sales contract. See, e.g., *Piney Woods Country Life School v. Shell Oil Co.*, 726 F.2d 225 (5th Cir. 1984); *Sunflower Elec. Coop. v. Tomlinson Oil Co.*, 7 Kan. App. 2d 131, 638 P.2d 963 (1981). If the court must look to the subsequent gas contract in determining rights under the lease, then the modern concept of commercial impracticability affords realistic opportunity for relief from oppressively burdensome agreements.

221. Oklahoma follows the universally accepted rule that a court will not make a better contract for the parties than they have actually made, nor alter a contract to the benefit of one and to the detriment of the other. See *Williams Petroleum Co. v. Midland Coops.*, 539 F.2d 694, 696 (10th Cir. 1976) (citing *Great Western Oil & Gas Co. v. Mitchell*, 326 P.2d 794 (Okla. 1958)).

the royalty clause is ambiguous.²²² If the clause in question is reasonably susceptible of more than one construction, when considered in the context of the entire agreement, then an ambiguity is present.²²³ In such a case, the court may look to many factors when determining the intent of the parties, including parol evidence²²⁴ and the circumstances existing at the time the agreement was reached.²²⁵ In the absence of any such evidence, rules of construction are available to the courts to aid them in applying a meaning to language in doubt.²²⁶ If, on the other hand, the lease language is plain and expressed in commonly understood terms, fairly susceptible of only one meaning, then it is the duty of the court to enforce the intentions of the parties at the time of contracting as actually expressed in the written language.²²⁷ In such a case, the court should determine the rights of the parties from the language alone and without regard to extrinsic evidence. In the absence of ambiguity, the court should not speculate on what the parties surely must have meant.²²⁸

The *Tara* court did engage in this type of speculation to establish its rule, which may yet return to haunt both Oklahoma courts and Oklahoma gas producers.²²⁹ Initially, it should be noted that neither the *Tara* royalty clause, nor the dispute itself, involved any of the common

222. See *Taylor v. Beech Aircraft Corp.*, 407 F. Supp. 69, 72 (W.D. Okla. 1976) (citing *Major v. Bishop*, 462 F.2d 1277 (10th Cir. 1977)). Language is unambiguous only if reasonably and fairly susceptible of one meaning. *Id.*

223. See *Minor v. Blanton*, 206 Okla. 382, 386-87, 243 P.2d 1008, 1012-13 (1952). Of course, even in the absence of ambiguity, the court, in determining the intent of the parties as drawn from the four corners of the written document, should attempt to place itself as nearly as possible in the positions of the parties when the contract was entered into. *Id.* at 387, 243 P.2d at 1013. Additionally, the purposes and circumstances surrounding the transaction are a permissible inquiry in interpreting such express intent. *Id.*

224. 206 Okla. at 387, 243 P.2d at 1013.

225. *Id.*

226. The rule of construction most commonly seen in the *Tara* type of disputes is the application of construction against the party who selected the disputed language. See *supra* notes 204-05 and accompanying text. Still, the principal rule of construction is always to determine, and put into operation, the intent and the object of the contracting parties. *Strange v. Hicks*, 78 Okla. 1, 3, 188 P. 347, 349 (1920). The court may not, under the guise of construction or otherwise, read into a contract words or terms which are not fairly contained within its language. *Phoenix Oil Co. v. Mid-Continent Petroleum Corp.*, 177 Okla. 530, 533, 60 P.2d 1054, 1057 (1936).

227. See *supra* note 219.

228. See *supra* notes 214, 219, 222.

229. Such speculation was clearly involved in *Tara*. Abandoning the express language used, the Oklahoma Supreme Court stated: "We do not believe that the lessors in this case, the original lessee, or the assignee-producers ever contemplated that the lessors' royalty could be half of what the producers received for the gas." 630 P.2d at 1273.

The case law of Louisiana is illustrative of a jurisdiction where disputes over market value royalty clauses have risen in instances where market value fell short of the lessee's proceeds, as well as where that value far surpassed the gas contract price. See *supra* notes 142-53, 161-69 and accompanying text.

variations which have given rise to claims of ambiguity. For example, the gas royalty clause in question did not distinguish between sales at the wellhead and sales off of the leased premises.²³⁰ Additionally, the decision does not reflect any alternative argument that, in the event market price does not mean proceeds *per se*, it must mean a price set at the time of the lessee's gas contract rather than a current prevailing market price.²³¹ Finally, *Tara* involved no argument or authority regarding proof of market price either in a free or in a regulated market.²³² In short, the Oklahoma Supreme Court was simply requested to determine the meaning of market price at the well, but instead expanded its decision far beyond the facts before it.

For its rationale, the *Tara* court first noted the usual necessity of marketing gas under long-term purchase contracts. The court believed this industry practice to be known and considered by parties to oil and gas leases when they are negotiating.²³³ From this, the court concluded that the parties to the lease could not have intended that the royalty fluctuate with market value while the lessee's gas contract price, subject of course to escalation factors, remained constant.²³⁴ In accordance with its speculation as to what the parties must have intended, the court then held that the term market price at the well is ambiguous and that the interpretation of market price as proceeds under these circumstances is "consonant with the intent and understanding of parties to oil and gas leases."²³⁵

Reasoning that any other approach would constitute a penalty to the lessee who was forced into a long-term gas contract by its duty to market the lessor's gas, the court asserted the fairness of this rule to both parties.²³⁶ This reasoning departs radically from established principles of contract construction. An ambiguity in an agreement, if it exists at all, must have existed at the time the agreement was entered into.²³⁷ An

230. See, e.g., *Piney Woods Country Life School v. Shell Oil Co.*, 726 F.2d 225 (5th Cir. 1984); see also *supra* notes 191-212 and accompanying text.

231. See, e.g., *Henry v. Ballard & Cordell Corp.*, 418 So. 2d 1334 (La. 1982); see also *supra* notes 161-69 and accompanying text.

232. See, e.g., *Matzen v. Cities Serv. Oil Co.*, 233 Kan. 846, 667 P.2d 337 (1983); *Shell Oil Co. v. Williams, Inc.*, 428 So. 2d 798 (La. 1983); see also *supra* notes 137-41, 161-69 and accompanying text.

233. *Tara*, 630 P.2d at 1273. But see *supra* notes 206-07 and accompanying text.

234. *Id.*

235. *Id.* at 1274; see also *supra* notes 36-38, 52-53 and accompanying text.

236. *Id.* But see *supra* notes 208-12 and accompanying text.

237. A court will not conform a contract to the desire of the party manifested after the agreement has been made. See *Siler v. Read Inv. Co.*, 273 Wis. 255, 261, 77 N.W.2d 504, 509 (1956). To allow a party to plead and prove subsequent matters is to provide, by judicial fiat, a shelter from the

otherwise straightforward contract term may not be attacked on the grounds that subsequent events have purportedly rendered that term uncertain of meaning.²³⁸ By emphasizing the lessee's duty to market and its being forced to enter into a long-term contract,²³⁹ the *Tara* court approached the problem from the wrong end. It may be that a lessee is forced by market conditions into entering a long-term gas contract, although that certainly did not prove to be the case in *Tara*. However, even if the market conditions had rendered such a result, the lessee was not forced to agree to a market price royalty lease clause. The lessee had no obligation to the lessor at all until the lease contract was executed and was not limited to market price language alone to provide for a royalty. If notice of the usual practice in the industry is attributable to both parties, certainly a lessee negotiating a royalty in 1973 was not only well aware of the potential for marketing under a long-term contract, but also of the modern wave of disputes over these types of lease clauses.²⁴⁰

Under these circumstances, a lessee who provides for a market price royalty clause, either in a lease prepared by the lessee, its draftsmen, or attorneys, or in a printed form supplied by the lessee, must be considered to have had the opportunity to limit the royalty obligation to its own proceeds if desired.²⁴¹ At least one noted commentator has referred to such a rule of construction as a "knee jerk" construction against the lessee.²⁴² This is simply not the case. United States courts have historically and universally construed ambiguous contracts most strictly against the drafter of the agreement, or the proponent of the printed form.²⁴³ This rule is neither unfair nor unreasonable. If, in the face of what the *Tara* court deemed to be well-known industry practices, the lessee uses a market price royalty clause, then the common meaning of the term

detriment caused by the failure of an assumed risk. See *supra* notes 210-12, 215-17 and accompanying text. The fact that subsequent events have resulted in a dispute over contract language does not make it ambiguous. See *Needles v. Kansas City*, 371 S.W.2d 300, 304 (Mo. 1963).

238. See *Needles*, 371 S.W.2d at 304.

239. See *supra* notes 41-47 and accompanying text.

240. As noted in *Tara*, several jurisdictions had previously determined similar disputes. See *supra* note 3.

241. See *supra* notes 202-03 and accompanying text.

242. *Lowe, Eastern Oil and Gas Operations*, *supra* note 4, § 20.03[2][c], at 20-34.

243. If, in fact, the term "market price" or "market value" is to be treated as ambiguous, extrinsic evidence should be admitted, including testimony of the parties and evidence of negotiation, in clarifying the contract. This rule of construction against the drafter need only be resorted to in the absence of such other evidence of intent. Certainly, the application of a rule of construction in this fashion is less objectionable than determining the intent of parties to a particular agreement from the purposes of original draftsmen of the form language used, without any relationship to the contract in dispute.

should be applied.²⁴⁴ The lessor would not then have bargained for consideration of market value royalty to have it subsequently judicially abridged because the lessee's performance is no longer profitable. As has been noted earlier, the lessee's difficulty is not "a web of the Court's weaving,"²⁴⁵ and the contract should not be rewritten to enhance the lessee's profits at the expense of the lessor.

Nonetheless, the court in *Tara* could not bring itself to enforce the contract against the lessee where it had become financially burdensome. As the Fifth Circuit wryly noted in *Piney Woods*, with respect to Mississippi law, the legislature may, if it wishes, enact a relief fund to assist these short-sighted lessees.²⁴⁶ The courts should not deprive Oklahoma royalty owners of the expected fruits of their bargains by judicial distortion of unambiguous lease clauses. The term "market price" has long had an established and accepted meaning,²⁴⁷ and market fluctuations which are reflected in that price are foreseeable to lessees.²⁴⁸ The occurrence of such market activity should have no impact on the rights of lease parties who have chosen to base their expectations of profit on the direction the market takes during the term of the lease. To take into account such an impact is an unwise interference with the bargaining processes and business decisions of an experienced and established industry.

VI. CONCLUSION

The weight of current authority on the issue presented in *Tara* supports a rule that the terms "market price" and "market value" used in gas royalty clauses are neither arcane nor ambiguous. There is little if any authority that there is a distinction between the two terms. At a minimum, courts of other jurisdictions have subjected such language to extrinsic evidence and, as a last resort, to rules of construction as an aid in determining the intent of the parties as actually expressed by the language used. To the contrary, the *Tara* rule does a grave disservice to the mineral owners of Oklahoma.

All of this notwithstanding, parties involved in the negotiation and preparation of oil and gas leases should be extremely cautious in drafting

244. See OKLA. STAT. tit. 15, § 161 (1984); see also *supra* notes 207, 222.

245. *Foster v. Atlantic Ref. Co.*, 329 F.2d 485, 490 (5th Cir. 1964). The well-known nature of the necessity of long-term gas contracts was recognized even in the earliest cases. See, *id.* at 488.

246. *Piney Woods*, 726 F.2d at 237.

247. See *supra* note 60.

248. See *Piney Woods*, 726 F.2d at 237.

provisions for gas royalty, taking into consideration all types of disputes which these clauses have engendered. If the lessor's royalty is to be based upon the lessee's actual revenues, then express language creating a proceeds-type lease should be considered to be absolutely essential. On the other hand, references to market price or market value should clearly reflect the intent of the parties with respect to the time and place such value is to be determined. The courts should not be left with the burden of determining these questions, particularly in light of the staggering amount of litigation over these very issues.

Without doubt, disputes may arise under a large number of leases which were prepared and entered into long before *Tara*, and many even before the advent of the case law of the last two decades. For resolution of disputes which spring from these leases, the Oklahoma Supreme Court should, if given the opportunity, commit itself to the task of enforcing the bargained for lease agreements according to their terms and the actual intent of the parties. However well-intentioned the rationale of *Tara* in seeking what the court perceived as fairness to both parties, the simple fact is that any contractual relationship creating rights and obligations for a marketable commodity carries with it the promise of expectations come to fruition, as well as the potential for realization of loss from assumed risks. It is not for the court to rewrite such agreements to the satisfaction of either party simply because the failure of expectations and the materialization of loss create an apparent unfairness. The reality of the market place, when unhindered by judicial intervention, provides the vehicle by which the parties to economically unrealistic agreements may be stimulated to renegotiation to reflect more nearly current economic conditions. Such an approach to a dispute, similar to the one faced by the Oklahoma Supreme Court in *Tara*, is more likely to lead to a fair and just result than can possibly follow from the rewriting of oil and gas leases by judicial decree. In the former instance, all parties and the general market place stand to benefit. In the latter, as particularly demonstrated by the *Tara* decision, the lessor is stripped of its bargain while the lessee obtains a better agreement than it actually made, having stood ready to accept the rights and benefits of its lease, but being relieved of its burdens in the event its judgment in negotiating the lease proves to be unsound.

