Recent Developments in Oil & Gas Law

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Carolyn J. Clegg

Ms. Clegg is a partner in the Magnolia firm of Keith, Clegg & Eckert. She is a 1973 graduate of Baylor University and a 1978 graduate of the University of Arkansas School of Law. She has been actively involved in the Arkansas Bar Association Natural Resource Law Section, serving as Secretary, and as a member of the Council. She is currently serving as a Vice Chair of the American Bar Association Section of Natural Resources, Energy and Environmental Law.
RECENT DEVELOPMENTS IN
ARKANSAS OIL & GAS LAW

Carolyn J. Clegg
KEITH, CLEGG & ECKERT
Magnolia, Arkansas

CASES

A. REPORTED ARKANSAS and ARKANSAS FEDERAL CASES

(1) Gilbreath v. Union Bank, 309 Ark. 360, 830 S.W.2d 854 (1992)

Before effective date of legislation permitting separate assessments for severed mineral interests, failure to subjoin assessment of mineral interests voided subsequent tax deeds as to those interests. Trustee holding record title to mineral interests sold at tax sale was not foreclosed from contesting validity of quiet-title decree more than 90 days after decree, where trustee was never notified by personal service or warning order of quiet title action, and limitation statute specifically allowed court to entertain independent action to relieve from judgment any party not personally served with process.
(2) Moore & Munger Marketing and Refining, Inc. v. Hawkins, 962 F.2d 806 (8th Cir. 1992)

Lessee of Chapter 7 debtor's oil pipeline system was not entitled to adjustment in contract price for purchase of "division orders", which described what properties produced oil delivered through pipeline and named persons who should receive payment for that oil, even though 59 orders were maintained by company other than debtor and 82 pertained to properties not producing oil; agreement provided a price adjustment only for those "division orders" rejected after initial 15 day period and only under certain specified conditions, and lessee did not contend that it rejected orders at issue after 15-day period or for any of the stated conditions.


Where a conveyance and bill of sale, purportedly for an oil well, also conveyed "Oil and Gas Leases", the instrument was ambiguous as to whether it conveyed only the the well or the oil and gas leases in the unit, and the Chancellor correctly allowed parol evidence to aid in the construction of the vague phrase "Oil and Gas Leases".
Klein v. Jerral W. Jones and Michael v. McCoy, _______F.2d _________(8th Cir. 1991)

These class action cases filed were by representatives of a class of about 3,000 royalty owners whose claims derived from oil and gas leases on property located in the Arkoma Basin in Western Arkansas. The royalty owners were seeking to share in the take-or-pay settlement between Arkoma (Jones and McCoy) and Arkla. The trial court found that the royalty owners were not entitled to share in the absence of "production", and further held that the three-year Statute of Limitations was applicable to a breach of the implied covenant to market gas. On April 21, 1991, the trial court entered its order dismissing the entire action. The Eighth Circuit Court of Appeals on November 24, 1992, reversed the dismissal of the action on the grounds that the action was barred by the Statute of Limitations and remanded to the trial court. The Court determined that money received by a lessee in exchange for surrendering a valuable claim under the take or pay provisions of the contract is a benefit that should be shared with the royalty owners.
Suit by mineral owners to cancel 30 year old leases for breach of implied covenants to protect from drainage and to further develop and explore and to recover damages for drainage. Chancellor cancelled leases (except for existing bore holes) for failure to further develop but awarded no damages for drainage. Both sides appealed.

Where there was no abstract, by either the Appellants or the Cross-Appellants, of the Complaint, the Cross-Complaint, or either of the Answers, nor was there an abstract of the Chancellor's findings of fact on the final order, the Arkansas Supreme Court held that it had no choice but to affirm the final order for failure of the parties to comply with Rule 9(d); it is necessary for a party to abstract the essential parties of the proceedings relied upon for appeal purposes.

B. Cases of Interest Currently (1/1/93) on Appeal

(1) Emily Kitchens Kolb, et al v. Issac Morgan, et al No. 92-01344, Appeal from Chancery Court of Columbia County Arkansas, to the Arkansas Supreme Court.
An interpleader action involving a partition in kind by family members in 1952. Issue was whether or not as a result of a prior mineral conveyance by one family member, the partition vested title in fee simple to the family members on only title to the surface. Chancellor held that only the surface estate was partitioned by the Court in its Partition Decree in 1952. An appeal has been filed by the Defendants.

(2) Crystal Oil Company, et al vs. Donald Warmack, No. 92-01102, Appeal from Chancery Court of Union County, Arkansas to the Arkansas Supreme Court.

Case involving cancellation of a 1963 oil and gas lease (covering 200 acres), insofar as it pertained to 120 acres, for failure of original lessee and its assigns to continue the development of the entire lease and, in particular, the 120 acres for 22 years, and for abandonment of purposes of the contract for many years prior to 1985. The Chancellor cancelled the lease as to the 120 acres, and ordered that Defendants make an accounting to Plaintiff. Defendants appealed.
Ray GILBREATH v. UNION BANK, Successor Trustee of
the Catherine C. Morgan Trust
92-52
Supreme Court of Arkansas
Opinion delivered May 11, 1992

1. Taxation — Tax Assessment — Effect of Failure to Subjoin
Assessment of Mineral Interest to Assessment of Surface
Interest. — Although the General Assembly has passed legisla-
tion to permit separate assessment for severed mineral interests, the
law at the time the tax deeds were issued was that failure to subjoin
the assessment of mineral interests did void subsequent tax deeds
for those interests purchased at tax sales.

2. Judgment — Attack by Interested Non-Party After Ninety
Days. — The trustee, as the owner of the mineral interest, was never
appropriately notified by personal service or warning order of
appellant's lawsuit to quiet title and should not be bound by the
resulting decree, especially in light of the language in Ark. R. Civ.
P. 60(k) that specifically provides that the rule does not limit the
power of the court to entertain an independent action to relieve a
party from a judgment when that party was not served personally
with process.

3. Process — Service of Process by Publication — Burden of
Proof on Party Attempting Service. — The burden is on the
party attempting service by publication to attempt to locate the
missing or unknown defendant, and is required to demonstrate to
the court, by affidavit or otherwise, that after diligent inquiry, the
defendant's identity or whereabouts remains unknown.

4. Process — Service of Process by Publication — Affidavit
Facially Defective — Service Improper. — Where no diligent
inquiry was made under Ark. R. Civ. P. 4(f)(1), as evidenced by
appellant's failure to conclude in his affidavit that the location of the
original trustee was unknown, the appellant's affidavit for a
warning order was facially defective.

5. Appeal & Error — Supplemental Abstract Helpful but Not
Necessary. — Where appellee's supplemental abstract was help-
ful, but not considered to be necessary under Ark. Sup. Ct. R. 9(d)
for an understanding of the issues presented, the motion for costs
was denied.

Appeal from Sebastian Chancery Court; Harry A. Foltz,
Judge; affirmed; Motion for Costs, denied.

Daily, West, Core, Coffman & Canfield, by: Janice West Whitt, for appellee.

ROBERT L. BROWN, Justice. This appeal relates to the validity of five tax deeds granted to the appellant, Ray Gilbreath, for mineral interests in land located in Sebastian County. The chancery court entered summary judgment, setting aside a decree which quieted title in those interests in the appellant. The appellant now appeals and asserts error on grounds a) that the Trustee was procedurally foreclosed from attacking the decree, and b) that the chancery court erred in finding the tax deed void. We disagree, and we affirm the chancery court's decision.

The facts are somewhat involved. On August 31, 1970, Catherine C. Morgan, a California resident, deeded the mineral interests in question to herself as trustee of the Catherine C. Morgan Trust. She was not the owner of the surface rights, and the surface rights were not involved in this litigation. On October 12, 1978, Morgan died, and California First Bank (now Union Bank) was named successor trustee by the California Superior Court. On July 27, 1981, California First Bank (now Union Bank), as Trustee, executed an oil and gas lease in favor of Stephens Production Company covering part of the mineral interests in question. This lease was recorded in the Sebastian County Circuit Clerk's office on October 31, 1981, but the deed indexes did not reflect that the lessor bank was leasing the mineral interests to Stephens in its capacity as Trustee. The mineral interests were not subjoined to the surface interests for assessment purposes in 1981.

Real estate taxes were not paid on the mineral interests in 1981, and those interests were declared to be delinquent and forfeited to the state that same year. In November 1982, the appellant bought the mineral interests at a tax sale conducted by the Sebastian County Sheriff, and on January 11, 1985, the Sebastian County Clerk granted five tax deeds to him for the mineral interests which he duly recorded on January 14, 1985.

On May 13, 1985, the appellant filed a petition to quiet title for the mineral interests and named as defendants Catherine C. Morgan, both individually and in her capacity as trustee, and all
other persons, known and unknown, who claimed any interest in
the mineral rights. That same day an affidavit for warning order
was executed by the appellant, which gave Morgan's last known
address but did not state that her whereabouts was unknown.
Also on May 13, 1985, the Sebastian Chancery Clerk issued a
Notice of Quiet Title Action for publication as the warning order.
On May 17, 1985, an appointed attorney ad litem sent a letter to
Morgan's last known address in California which was returned
unclaimed on June 18, 1985. When no response resulted, a decree
quieting title to the mineral interests in the appellant was entered
on July 22, 1985.

Four years later, on July 24, 1989, the Trustee filed an action
to set aside the quiet-title decree on grounds that the appellant's
tax deeds were void because the 1981 assessments of the mineral
interests were not subjoined to those of the surface owners. An
additional ground for relief was the failure to serve the Trustee, as
owner of the mineral interests. The Trustee asked the court to set
aside the quiet title decree and for repayment of the royalties paid
to the appellant. The Trustee also moved for summary judgment.
On July 2, 1991, the chancery court granted the Trustee the relief
requested and entered summary judgment in its favor.

[1] The pivotal issue in this case is whether the failure of the
Sebastian County Assessor to subjoin assessments of mineral
interests to assessments of surface interests in 1981 rendered the
resulting tax deeds void. We hold that it did. Our law at that time
was clear that the failure to subjoin the assessment of mineral
interests did void subsequent tax deeds for those interests pur-
chased at tax sales. Garvan v. Potlatch Corp., 278 Ark. 414, 645
S.W.2d 957 (1983); Hurst v. Rice, 278 Ark. 94, 643 S.W.2d 563
(1982); Adams v. Bruder, 275 Ark. 16, 627 S.W.2d 12 (1982);
Sorkin v. Meyers, 216 Ark. 908, 227 S.W.2d 958 (1950). We are
aware that the General Assembly passed legislation, effective
April 15, 1985, to permit separate assessments for severed
mineral interests, but that was long after the 1981 assessments
which are at issue in this case. See Act 961 of 1985, now codified
as Ark. Code Ann. § 26-26-1112 (1987). Accordingly, the
chancery court was correct in its decision, and the tax deeds were
void from date of the 1981 assessments due to failure to subjoin.

[2] The appellant further contends that the Trustee was
foreclosed under Ark. R. Civ. P. 60(k) from coming into court more than ninety days after the quiet-title decree and contesting the validity of that decree. We hold otherwise on the basis that the Trustee, as the owner of the mineral interests, was never appropriately notified by personal service or warning order of the appellant's lawsuit to quiet title and should not be bound by that decree. See Hurst v. Rice, supra. The Trustee was entitled to have its day in court and to raise the subjoinder issue, especially in light of the language in Ark. R. Civ. P. 60(k) which specifically provides that the rule does not limit the power of the court to entertain an independent action to relieve a party from a judgment when that party was not served personally with process.

It is undisputed that the Trustee was not personally served. Nor was it constructively served according to procedures required under Ark. R. Civ. P. 4(f)(1). Rule 4(f)(1) reads in part:

(1) Where it appears by the affidavit of a party or his attorney that, after diligent inquiry, the identity or whereabouts of a defendant remains unknown, service shall be by warning order issued by the clerk and published weekly for two consecutive weeks in a newspaper having general circulation in a county wherein the action is filed and by mailing a copy of the complaint and warning order to such defendant at his last known address, if any, by any form of mail with delivery restricted to the addressee or the agent of the addressee.

Here, the affidavit of the appellant did not state that, after making diligent inquiry, Catherine C. Morgan's whereabouts was unknown which is a condition in the rule for the warning order's issuance.

[3] Comment 12 to Rule 4(f)(1) explains the burden that a party must meet to avail himself of service by publication:

The burden is on the party attempting service by publication to attempt to locate the missing or unknown defendant. Such party or his attorney is required to demonstrate to the court, by affidavit or otherwise, that after diligent inquiry, the defendant's identity or whereabouts remains unknown.

That burden was simply not met in this case. The appellant filed
his petition to quiet title in the mineral interests on May 13, 1985, and on that same day filed an affidavit for a warning order which said:

That he has made diligent inquiry and that it is his information that the defendant, Catherine C. Morgan, Individually, and Catherine C. Morgan, Trustee, is a nonresident of the State of Arkansas . . . .

The appellant then listed Morgan’s last known address in California. Also, on May 13, 1985, the Sebastian County Chancery Clerk issued the warning order. Four days later, on May 17, 1985, the attorney ad litem for Catherine C. Morgan sent a certified letter to her California address which was returned unclaimed on June 18, 1985.

[4] Where no diligent inquiry is made under rule 4(f)(1), we have affirmed dismissal of a complaint for improper service of process. See Smith v. Edwards, 295 Ark. 182, 747 S.W.2d 580 (1988). It is obvious in the case before us that the requisite inquiry was not made because the appellant did not conclude in his affidavit that the location of Catherine Morgan was unknown. Accordingly, we hold that the appellant’s affidavit for a warning order is facially defective under Rule 4(f)(1).

To summarize, because there was no subjoinder of mineral interests to surface interests in the tax assessments in 1981, the five tax deeds granted the appellant in 1985 were void. Further, because the affidavit for warning order was deficient on its face under Rule 4(f)(1), constructive service by publication was not effective against the Trustee. Our decision on these points make it unnecessary to reach the other issues raised by the appellant.

[5] The Trustee moves for costs totaling $329.75 occasioned by preparation of a supplemental abstract which it deemed necessary for consideration of the appeal. While the pleadings and discovery requests abstracted by the Trustee were helpful on appeal, we do not consider that they were necessary under Ark.
Sup. Ct. R. 9(d) for our understanding of the issues presented. The motion for costs is denied.

Affirmed. Trustee’s motion for costs denied.
Based on the foregoing, we believe there is substantial evidence in the record to support the Secretary's denial of disability benefits for the time prior to September 30, 1979.

Onstead's remaining contention is rejected as without merit.

The order affirming the Secretary's denial of disability benefits is affirmed.

**MOORE & MUNGER MARKETING AND REFINING, INC., Appellant,**

**v.**


No. 91-3473.

United States Court of Appeals,
Eighth Circuit.


Lessee of Chapter 7 debtor's oil pipeline system sought determination that it did not owe the full contract price for purchase of "division orders," which described what properties produced oil delivered through pipeline and named persons who should receive payment for that oil. The United States Bankruptcy Court for the Western District of Arkansas, James G. Mixon, J., denied lessee's claim for relief, and lessee appealed. The District Court, Oren Harris, Senior District Judge, affirmed, and lessee appealed. The Court of Appeals held that lessee was not entitled to adjustment in contract price, even though 59 orders were maintained by company other than debtor and 82 pertained to properties not producing oil.

Affirmed.

**Mines and Minerals 79.1(3)**

Lessee of Chapter 7 debtor's oil pipeline system was not entitled to adjustment in contract price for purchase of "division orders," which described what properties produced oil delivered through pipeline and named persons who should receive payment for that oil, even though 59 orders were maintained by company other than debtor and 82 pertained to properties not producing oil; agreement provided adjustment only for those "division orders" rejected after initial 15-day period and under certain specified conditions, and lessee did not contend that it rejected such orders at issue after 15-day period or for any reason not stated in the conditions.

Charles Nestrud, Janie McFarlin, Little Rock, Ark., for appellant.

Gregory Hopkins, Charles Coleman, Ty Price, Little Rock, Ark., for appellees

Before FAGG and WOLLMAN, Circuit Judges, and BOGUE,* Senior District Judge.

PER CURIAM.

Moore & Munger Marketing and Refining, Inc. appeals from the district court judgment affirming the bankruptcy court's denial of its claim for relief.

Affirm.

1.

Macmillan Petroleum (Arkansas), ("MacArk") leased its oil pipeline system

2. The Honorable James G. Mixon, United States Bankruptcy Judge for the Western District of Arkansas.
MOORE & MUNGER MARKETING & REFINING v. HAWKINS
Cite as 962 F.2d 806 (8th Cir. 1992)

Moore & Munger Marketing and Refining, ("Moore"). MacArk also agreed to sell information—"division orders"—to Moore. The division orders described what properties produced oil delivered through MacArk's pipeline and named the persons who should receive payment for that oil.

The agreement stated that MacArk had division orders "currently in effect." Clause 1.2 of the agreement granted Moore the right to peruse the 358 division orders fifteen days and return those it did not want. The number of division orders retained after the fifteen day period comprised the "Purchased Number."

The agreement also noted that subsequent events could reduce the value of the information contained in the division orders. Clause 4 therefore provided that, under certain conditions, Moore could reject any or all of the division orders for any reason, but there was no provision for a corresponding price adjustment. The agreement provides a price adjustment only for those division orders rejected after the initial fifteen day period, and only under those conditions specified in Clause 4. Moore does not contend that it rejected the 141 division orders at issue after the fifteen day period, or for any of the causes stated in Clause 4. We therefore conclude that the district court properly held Moore liable for the full contract price, less an adjustment for the two division orders rejected in accordance with Clause 4.

The judgment of the district court is affirmed.

II.

Moore argues that de novo review is appropriate because the parties' written contract is unambiguous. See Case Int'l Co. v. T.L. James & Co., 907 F.2d 65 (8th Cir.1990) (review de novo district court's interpretation of an unambiguous contract).

As MacArk does not dispute this contention, we review the contract de novo.

Moore argues that the contract price should be revised to reflect the lack of value in the fifty-nine division orders maintained by another company and the eighty-two division orders pertaining to properties not producing oil.

The agreement does not allow for such an adjustment. Clause 1.2 permitted Moore to return any or all of the division orders for any reason, but does not provide for a corresponding price adjustment. The agreement provides a price adjustment only for those division orders rejected after the initial fifteen day period, and only under those conditions specified in Clause 4. Moore does not contend that it rejected the 141 division orders at issue after the fifteen day period, or for any of the causes stated in Clause 4. We therefore conclude that the district court properly held Moore liable for the full contract price, less an adjustment for the two division orders rejected in accordance with Clause 4.

The judgment of the district court is affirmed.

Appeal that conclusion. For the sake of convenience we will refer to the documents as division orders.
plaint moved to dismiss with prejudice his case against Dow Chemical. Dow Chemical then moved to dismiss with prejudice its cross-appeal. Both motions are granted.

Affirmed in part, reversed in part, dismissed with prejudice in part, and remanded for further proceedings.

Joe Wayne HARRIS and Elena Harris v. STEPHENS PRODUCTION COMPANY, et al.

92-269

Supreme Court of Arkansas
Opinion delivered June 29, 1992

1. CONTRACTS — PAROL EVIDENCE PROPERLY PERMITTED. — Where a conveyance and bill of sale, purportedly for an oil well, also conveyed “Oil and Gas Leases,” the instrument was ambiguous as to whether it conveyed only the well or the oil and gas leases in the unit, and the chancellor correctly allowed parol evidence to aid in the construction of the vague phrase “Oil and Gas Leases.”

2. REFORMATION OF INSTRUMENTS — NO ERROR SINCE DOCUMENT NOT REFORMED. — Since the trial court did not remake or reform the instrument, but rather allowed parol evidence for the purpose of construing the instrument as written, it did not err in “remaking” the instrument as appellant argues.

3. CONTRACTS — CONSTRUCTION — INSTRUMENT CONSTRUED AGAINST DRAFTER — PRIMARILY CONSTRUED TO GIVE EFFECT TO INTENTION OF PARTIES. — While an instrument is to be construed most strongly against the party that prepared it, the primary rule in the construction of instruments is that the court must, if possible, ascertain and give effect to the intention of the parties.

4. APPEAL & ERROR — FAILURE TO ARGUE POINT IN ORIGINAL BRIEF. — The court did not reach the merits of appellant's argument where it was not discussed in the appellant's original brief; points may not be argued only in reply.

Appeal from Crawford Chancery Court, Division I; Warren O. Kimbrough, Chancellor; affirmed.

Ray Edwards of Edwards & Edwards, Charles “Chuck”

Daily, West, Core, Coffman & Canfield, by: Michael C. Carter and Janice West Whitt, for appellee.

Robert H. Dudley, Justice. The plaintiffs, Joe and Elena Harris, filed this suit claiming a 100% working interest ownership of the oil, gas, and mineral rights in a 40-acre tract and the concomitant rights to the proceeds from a nearby commercially producing well that is located in the same drilling unit. The chancellor found the plaintiffs' claims to be without merit, and they appeal. The ruling of the chancellor was correct, and we affirm.

In 1961, Bert Tankersley leased his oil, gas, and mineral interest in 100 acres to Gulf Oil Corporation. The lease included the 40 acres at issue in the north half of section 8, plus 60 acres in section 9. Stephens Production Co., the defendant, and appellee, subsequently acquired the leasehold working interest of the 40-acre tract in section 8 and then pooled and unitized for drilling the north half of section 8 and the south half of section 5. Stephens owned 100% of the oil and gas leases in the 640-acre drilling unit. In 1970-71, Stephens drilled a gas well, the Harris-Chitwood No. 1, on the 40 acres in section 8. The well produced for six years, but ceased commercial production in 1977. When commercial production ceased, 70% of Stephens' leases in the unit lapsed due to non-production. Stephens held the remaining 30% by production since those leases contained acreage that was in other producing units. Earlier, in June 1968, Chevron had drilled the Chevron-Whitlock No. 1 Well in the section 9 drilling unit that contained the other 60 acres of the Tankersley lease. The Chevron-Whitlock No. 1 Well has produced in paying quantities since 1968 and so, unless otherwise terminated, Stephens holds the 40-acre tract by virtue of production on the 60 acres.

Plaintiffs, Joe and Elena Harris, through the years purchased four tracts of land, comprising about 500 acres, all located in the immediate area. One of the tracts, which was apparently purchased in 1974, is the 40-acre tract in section 8. The Harris-Chitwood No. 1 is located 2,000 feet north of plaintiffs' house.

After the Harris-Chitwood No. 1 ceased commercial pro-
duction, Stephens attempted without success to interest other production companies in drilling in the unit and, in 1980, decided to cap the well. When Stephens sent a crew to cap the well, plaintiff Joe Harris met them and asked them not to cap it, but instead to let the Harrises use the gas from the well for their home. A Stephens vice-president told Harris that he would have to get the approval of the Oil and Gas Commission. With the help of his attorney, Harris drafted a letter to the Commission asking it to allow him to assume the responsibility and the liability for the well and for the future expense of capping of it. The Commission responded by letter telling Harris what he would have to do in order to be allowed to use the well for his personal use. About a year later, Stephens wrote the Harrises and told them that it would cap the well if it did not hear from them in forty-five days. There was additional correspondence and then, in October of 1982, Stephens mailed to the Harrises a “Conveyance and Bill of Sale,” with a copy to the Commission and to the plaintiffs’ attorney. The Harrises paid nothing for the conveyance. In 1983, the commission gave the Harrises the right to use the well for household purposes.

In 1986, TXO Production Corp. became interested in drilling another well in the same unit in which the Harris-Chitwood No. 1 is located and, to that end, leased some of the Harrises’ other property, but not the 40 acres at issue. TXO declined to take a lease from the plaintiffs on the 40 acres at issue because it concluded that was held by Stephens as a result of production. Stephens participated in the drilling of the well, the Wamock No. 1, which was successfully completed in December of 1986. The well is in commercial production, and Stephens has paid royalties to the plaintiffs since production began. Over two years after the completion of the Wamock No. 1, the plaintiffs filed this suit claiming a 100% working interest ownership in the 40-acre tract because of the 1982 “Conveyance and Bill of Sale.” Stephens counters that the conveyance shows on its face that it conveyed only the well, while the plaintiffs contend that it conveyed the entire unit. The chancellor ruled that some of the language in the instrument was ambiguous and allowed parol evidence to determine the true intent of the parties. The plaintiffs assign this ruling as error. The nature of the case itself tends to show the correctness of the chancellor’s ruling. The Harrises
content that the instrument conveyed the gas leases in the unit, while Stephens contends that it conveyed only the well. The instrument provides:

That in consideration of the sum on ONE DOLLAR ($1.00), the receipt of which is hereby acknowledged, and the further release of all liability and responsibility, STEPHENS PRODUCTION COMPANY does hereby SELL, DELIVER and TRANSFER unto JOE HARRIS, Route 1, Alma, Arkansas 72921, all of its interest in and to the physical equipment, Oil and Gas Leases, and all other property rights owned, used or held by it in connection with the Harris-Chitwood #1 Well located 850 feet East and 530 feet South of the Northwest corner of the Northeast Quarter of the Northwest Quarter of the Northeast Quarter (NW/4 NE/4) of Section 8, Township 9 North, Range 30 West, Crawford County, Arkansas. This conveyance is made without warranty of title, either express or implied, and is also without representation as to the quantity, quality or continued life of the subject well.

Joe Harris, by the acceptance of this conveyance, hereby agrees and stipulates that the interest conveyed hereby shall not be transferred or conveyed, in whole or in part, to any other person or party and the gas, if any, produced from said well shall not be sold, bartered or conveyed to any other person or party, it being understood that the gas is for the personal, sole and exclusive use of Joe Harris on the premises adjacent to the wellhead.

As a part of the consideration for this transfer, Joe Harris hereby stipulates and agrees that Stephens Production Company shall not be responsible for the plugging of said well nor shall it be liable for any claims or obligations in connection with the production of gas therefrom. Joe Harris agrees hereby to hold Stephens Production Company harmless from the claims of all persons whomsoever arising out of or in connection with the operation or production of gas from the Harris-Chitwood #1 Well and from any and all actions, causes of action, claims and demands for, upon, and by reason of any damage, loss or injury sustained by anyone in consequence of the further
operations of said well.

EXECUTED this 11th day of October, 1982.

With the exception of one phrase, the instrument would not be ambiguous, and its purpose clearly would have been only to sell, deliver, and transfer to the plaintiffs the well. However, in the seventh line, the instrument contains the phrase “Oil and Gas Leases” and, arguably, the instrument could be construed to mean that it conveyed Stephens’ oil and gas leases in the unit. Thus, it contained an ambiguity, and the chancellor allowed parol evidence to aid in the construction of the vague phrase. The chancellor’s ruling was correct. In Mays v. Barnett, 150 Ark. 492, 496, 234 S.W. 488, 489 (1921), we quoted with approval from Brown & Hackney v. Daubs, 139 Ark. 53, 213 S.W. 4 (1919) as follows:

Parol evidence to vary the terms of a written contract is one thing; such evidence to enable the court to say what the parties to a contract intended to express by the language adopted in making it is quite another thing. The former is not permissible. . . . The latter is permissible, and is often absolutely essential to show the real nature of the agreement. . . . Both rules are elementary, and do not conflict in the slightest degree with each other. . . . A failure to keep in mind the wide distinction between varying a contract by parol evidence and resorting to such evidence in aid of its construction often leads to error. [Emphasis added.]

[1] The attorney who drafted the instrument for Stephens testified that the purpose of the phrase was to give the plaintiffs the leasehold interest in the well itself, and the Harrises would then be responsible in the event other royalty owners in the unit asked for royalties on the gas used in the Harrises’ house, or if the State assessed severance tax on the gas used by plaintiffs, or if there was a State conservation assessment on that production. The attorney testified that there was no intent to give the plaintiff all of the leases in the unit. Other correspondence between plaintiffs, Stephens, and the Commission, shows that, at the time of the instrument, the plaintiffs’ understanding and intention was that they were to receive Stephens’ ownership only in the Harris-Chitwood No. 1, subject to the conditions imposed in the
instrument. In sum, the chancellor correctly allowed parol evidence to aid in the construction of the vague phrase "Oil and Gas Leases."

[2] The plaintiffs next argue that the trial court erred in remaking the instrument. We summarily reject the argument. The trial court did not remake or reform the instrument, rather it allowed parol evidence for the purpose of construing the instrument as written.

[3] The plaintiffs' final two arguments are treated together. They argue that the trial court erred in failing to construe the instrument most strongly against the party that prepared it and that the decision is clearly erroneous. While an instrument is to be construed most strongly against the party that prepared it, the primary rule in the construction of instruments is that the court must, if possible, ascertain and give effect to the intention of the parties. Sternberg v. Snow King Baking Powder Co., Inc., 186 Ark. 1161, 57 S.W.2d 1057 (1933). Even when this instrument is construed most strongly against the party that prepared it, the plaintiffs cannot prevail. Finally, the ruling of the chancellor, rather than being clearly erroneous, is eminently correct.

[4] In their reply brief, plaintiffs argue that the chancellor erroneously concluded that Stephens held the lease to the 40 acres by production in the neighboring unit. We do not reach the merits of this argument, as it was not discussed in the plaintiffs' original brief, and points may not be argued only in reply. Myers v. Muuss, et al., 281 Ark. 188, 662 S.W.2d 805 (1984).

Affirmed.

Brown, J., not participating.
United States Court of Appeals
FOR THE EIGHTH CIRCUIT

No. 91-1995

Bob Klein and Genevieve Klein, *
John Frank Pendergrass, Sam *
Thompson, Margaret Schaffer, *
Clymer Law, and Donnie Hall, *

Plaintiffs/Appellants,

v.

Jerral W. Jones and Michael *
V. McCoy,

Defendants/Appellees.

No. 91-2239

Bob Klein and Genevieve Klein, *
John Frank Pendergrass, Sam *
Thompson, Margaret Schaffer, *
Clymer Law and Donnie Hall, *

Plaintiffs/Appellants,

v.

Arkoma Production Company, *
Arkla, Inc., Arkla Exploration *
Company, Jerral W. Jones and *
Michael McCoy,

Defendants/Appellees.

Appeals from the United States District Court
for the Western District of Arkansas

Submitted: January 8, 1992
Filed: November 25, 1992
BACKGROUND

The events leading up to this lawsuit occurred against a background that was recently discussed by the Supreme Court. We quote from the syllabus:

In response to ongoing natural gas shortages, Congress enacted the Natural Gas Policy Act of 1978 (NGPA), which, inter alia, established higher price ceilings for "new" gas in order to encourage production and carried over the pre-existing system of "vintage" price ceilings for "old" gas in order to protect consumers. However, recognizing that some of the vintage ceilings might be too low, Congress, in § 104(b)(2) of the NGPA, authorized the Federal Energy Regulatory Commission to raise them whenever traditional pricing principles under the Natural Gas Act of 1938 (NGA) would dictate a higher price. After the new production incentives resulted in serious market distortions, the Commission issued its Order No. 451, which, among other things, collapsed the existing vintage price categories into a single classification and set forth a single new ceiling that exceeded the then-current market price for old gas; established a "Good Faith Negotiation" (GFN) procedure that producers must follow before they can collect a higher price from current pipeline customers, whereby producers may in certain circumstances abandon their existing obligations if the parties cannot come to terms; and rejected suggestions that the Commission undertake to resolve in the Order No. 451 proceeding the issue of take-or-pay provisions in certain gas contracts. Such provisions obligate a pipeline to purchase a specified volume of gas at a specified price, and, if it is unable to do so, to pay for that volume. They have caused significant hardships for gas purchasers under current market conditions.

FACTS

The named plaintiffs/appellants are the representatives of a class of about 3,000 royalty owners. Their claims derive from oil and gas leases on property located in the Arkoma Basin, in Western Arkansas. Defendant/appellee Arkla, Inc. (Arkla) is a corporation with its principal place of business in Shreveport, Louisiana. Defendant/appellee Arkla Exploration Company (ABC) is likewise a corporation with its principal place of business in Shreveport. At all times relevant, it was a wholly-owned subsidiary of Arkla, Inc., and operated as the exploration and production company of Arkla, Inc. Arkla Energy Resources (AER), while not a named party, is a division of Arkla, Inc, which operates Arkla's pipeline.

Defendants/appellees Jones and McCoy founded Arkoma as an Arkansas corporation in 1981. Jones owned two-thirds of the stock and McCoy owned one third. Jones was chairman of Arkoma’s board of directors and a corporate officer, and McCoy was Arkoma’s president and its chief geologist and engineer. Arkoma was in the business of natural gas exploration, development and production. They sold their interests in the company to ABC on December 31, 1986. Jones and McCoy were joined as defendants in this action by virtue of this sale and the assignment to Arkoma, prior to that sale, of their interests in various producing wells involved.

The various Arkla entities will be collectively referred to as "the Arkla parties" or as, simply, "Arkla" unless the context otherwise warrants. In such cases they will be designated as "Arkla", "AER", "ABC", or "Arkoma".

Development in the two primary fields, the Aetna and Cecil Fields, commenced in the 1950’s. Typically, mineral owners gave leases to production companies which provided for the payment of royalty based on the market value of 1/8 of the gas sold or used off the premises, or 1/8 of the amount realized from the sale at
the wellhead. Many leases in the Cecil Field contained a fixed rate royalty provision which calculated the royalty at 1/8 of the value fixed at a certain amount per thousand cubic feet (mcf) of gas sold. Those fixed price leases were converted to market value leases in separate litigation in the Chancery Court of Franklin County, Arkansas, in 1990.

On December 31, 1982, Arkoma, then owned by Jones and McCoy, agreed with Arkla, a major developer in the Arkoma Basin, to purchase one-half of Arkla’s leasehold interest for $16 million. Arkoma agreed to spend an additional $30 million in a drilling program over a four year period, and to share additional acreage acquired in the Aetna and Cecil Fields from other lease owners. This transaction resulted in Arkoma and Arkla owning virtually all of the rights to drill new wells in the Aetna and Cecil Fields. Shortly thereafter, Jones became a member of the board of Arkla.

On February 24, 1983, Arkoma and Arkla executed a gas purchase contract, identified as GPC 5239, covering new wells to be drilled in the Aetna and Cecil Fields, as well as any other acreage to be acquired by Arkoma, and by which Arkla agreed to pay Arkoma the maximum lawful price under §§ 102 and 103 of the NGPA. At the time of the agreement, the § 102 price for the era was $3.83 per mcf. The contract contained a pricing provision which allowed Arkoma to renegotiate the contract price during its term. It provided a 75% minimum take-or-pay provision by which Arkla was obligated to take 75% of the daily deliverability from Arkoma’s wells, or to pay for a like amount of the gas at the contract rate¹. Arkoma committed

¹. Take or pay clause
A clause in a gas purchase contract requiring the purchaser to take, or failing to take, to pay for the minimum annual contract volume of gas under which the producer-seller has available for delivery. Under such clause the purchaser usually has the right to take gas paid for (but undelivered) in succeeding years. Such gas is called makeup gas. See Howard R. Williams and Charles J. Meyers, Oil and Gas Terms, 249 (1959), citing Howell, Gas Purchase
its working interests together with all royalty interests of the appellant class to the contract.

Arkoma began an aggressive drilling program, achieving a success ratio in excess of 90%, against an industry standard of only approximately 50%. In the process, Arkoma became one of Arkla's largest suppliers of gas.

In 1985-86, Arkla curtailed the quantities of gas it took from Arkoma, but did not honor the pay provisions of GPC 5239. By March, 1986, the outstanding take-or-pay billings from Arkoma to Arkla were in excess of $36 million, and were accruing at a monthly rate of approximately $3 million. At about that time, Jones resigned from the Arkla board. Arkla then refused to pay for the gas it had not taken. Arkla calculated that it was obligated to buy 40,000 mcf per day and was taking only 12,000 mcf; that the potential take-or-pay obligation owed to Arkoma could reach $54 million by the end of 1986 and would increase by $40 million during 1987, and it determined that only 10% of the take-or-pay billings were debatable.

Arkla entered into negotiations with Jones and McCoy to resolve the problem. The negotiations for settlement of the take-or-pay obligations were resolved on December 31, 1986, when Arkla simply bought its promise. The tax partnerships, (controlled and primarily owned by Jones and McCoy), which actually owned the producing wells, assigned all of their interests to Arkoma, as did Jones and McCoy, and then purchased all of Jones' and McCoy's stock in Arkoma, thus acquiring Arkoma Production Company and gaining the ability to renegotiate GPC 5239. Jones and McCoy assigned all drilling interests to Arkoma in exchange for a promissory note in the amount of $35 million, guaranteed by Arkla.
That note was paid the same day.

"New" Arkoma, that is, Arkoma as it existed after acquisition by AEC, also agreed to furnish Jones and McCoy, free of cost to them, 5.8 billion cubic feet (bcf) of gas over a five year period. AER agreed to purchase this gas at prices beginning at $4.77 per mcf in 1987, and escalating to $6.08 per mcf in 1992. To secure its obligation to purchase this gas, AER gave Jones and McCoy a promissory note in the amount of $24 million, which was the net present value of that gas purchase contract.

"New" Arkoma agreed to pay Jones and McCoy at the rate of $1.62 per mcf for any newly established additional reserves. For the stock in Arkoma, Arkla paid Jones and McCoy, in addition to satisfying the promissory note of $35 million, a cash consideration of $14 million. The total consideration paid by Arkla on December 31, 1986, was $73 million, $35 million for the promissory note, $24 million for the gas purchase contract to buy free gas, and $14 million for the Arkoma stock.

After the sales by Jones and McCoy to Arkoma of their lessee interests, and after the sale of Arkoma to AEC, and during the period of the settlement of the take-or-pay claims and renegotiation of GPC 5239, Arkoma was wholly owned by AEC (Arkla's production company). And AER, (the pipeline), was also wholly owned by Arkla.

On February 13, 1987, AER, AEC and Arkoma amended the price provisions and the take-or-pay provisions in GPC 5239. They reduced the contract price for gas from $3.83 per mcf to $2.20 per mcf, and released gas on the spot market for sale at prices less than $1.50 per mcf. Appellants, who knew nothing of the details of these confidential transactions of December 31, 1986, and February 13, 1987, and which the participants concealed from the Arkansas Public Service Commission, did not find out that they would be
receiving less money for their royalty interests until they received their January production payments from Arkla in late March, 1987.

After Jones and McCoy directed "New" Arkoma to drill additional wells, which they were entitled to do under the December 31, 1986, transactions, the parties had a new dispute. It concerned additional consideration due to Jones and McCoy for drilling of the new wells. To resolve the dispute AEC paid Jones and McCoy an additional $100 million in 1989, which included payment for reserves, the balance due on free gas, and interest.

On December 31, 1986, the fair market value of gas reserves in the ground was 83¢ per mcf. However, Arkla paid Jones and McCoy $1.62 per mcf. The difference in the fair market value of the reserves and the amount paid to Jones and McCoy represented the value paid to Jones and McCoy to settle Arkla's take or pay dispute under GPC 5239; and to put it in a position to amend the gas purchase contract.

Plaintiffs/appellants assert, and defendants/appellees do not contest, that except for the fixed rate leases, the royalty provisions took the following basic form:

Lessee shall pay Lessor as royalty on gas, casinghead gas, distillate, condensate, and other gaseous substance produced from said land and sold or used by Lessee off of the land or in the manufacture of gasoline or other products, the market value at the mouth of the wells of one-eighth (1/8) of such products so sold or used. On all gas, casinghead gas, condensate and distillate sold at the wells by the Lessee the royalty shall be one-eighth (1/8) of the amount realized from such sales.

The fixed rate royalty provisions took the following form:

The Lessee shall pay Lessor as royalty for gas the equal one-eighth (1/8) of the value of such gas calculated at the rate of Four (4¢) cents per thousand cubic feet corrected to two pounds above atmospheric pressure while the same is being sold or used off the premises.
Corporate Appellees' Appendix at 132 (emphasis added). As previously noted, in separate litigation the fixed rate leases were converted to market value leases. The fixed rate leases were:

Converted into leases providing for the payment of royalties based on the proceeds received at the wellhead from the sale of the produced gas. . . . As to the production from and after [July 1, 1990], all such royalties shall be paid by the lessees according to the proceeds, net of lawful taxes or assessments and other proper charges authorized by law or the lease agreements, if any, received by the lessees at the well for all gas produced from the leased premises. . . . Arkla warrants that the royalty payment level on its converted proceeds leases will be no less than the royalty payment level applicable to the market value leases as to which Arkla is a lessee in the Cecil Gas Field Settlement Area.

Glen Morris, et al. v. Arkansas Louisiana Gas Company, et al., In the Chancery Court of Franklin County, Arkansas, Charleston District, No. E-86-40, Final Order, Filed on May 21, 1990 (Exhibit 1 at 5).

While the briefs and the arguments refer frequently to contracts and agreements among developers and distributors—marketers of oil and gas—these plaintiffs/appellants claim as royalty owners and under leases between royalty owners and developers. And the plaintiffs/appellants' rights in these matters must arise out of the oil and gas leases executed by the royalty owners.

PROCEDURE

The lawsuit was filed February 23, 1990. Plaintiffs/Appellees Jones and McCoy filed a motion for summary judgment January 1, 1991. The Arkla defendants/appellees filed a motion for summary judgment January 18, 1991. Each group filed its Statement of Material Facts and, on March 4, 1991 the trial court, ruling from the bench during a hearing on a motion for summary judgment, dismissed all claims against Jones and McCoy and all claims against the other defendants, except the claim based on a breach of the
implied covenant to market gas. After a bench trial that lasted
seven days, the court found that the action was time barred and, on
April 21, 1991 entered its order dismissing the entire action. At
the request of the appellants, on May 7, 1991, the court entered an
order affirming the previous dismissals.

DISCUSSION

While the statements of the issues vary among the parties, the
areas of concern expressed by the trial judge covered all the
issues, and that outline will be followed here.

Further, in review of these issues this court will be guided
by the standard that the appellate court views the case in the same
manner as the trial court, Western Casualty & Surety Co. v.
National Union Fire Insurance Co., 677 F.2d 789 (8th Cir. 1982);
and we review the trial court’s rulings on the applicable state law
1217 (1991). We will turn, therefore, to the bench discussion of
the trial court at the hearing on March 4, 1991.

Turning now to the specific counts or claims made by
plaintiffs:

1. General Breach of Duty of Fair Dealing Arising from a
Fiduciary Relationship.

In Amoco Production Co. v. Ware, 269 Ark 313, 602 S.W.2d 620
(1980), the Arkansas Supreme Court carefully reviewed the
relationship of a developer to a lessor among a group of lessors
and recited the five implied warranties arising out of the lessor-
lessee relationship. It found no fiduciary relationship and it found no implied breach of fiduciary duty by lessee. Instead, it defined the duty owed each lessor, and to the lessors as a group, to act for the mutual advantage of both. It held that the lessee must act in a reasonable and prudent manner, using reasonable judgment, and not act arbitrarily.

In this case the take-or-pay elements in the developers contracts with the pipeline/marketer were, because of Federal Energy Regulatory Commission intervention, literally bankrupting the pipeline, and those facts must be considered in evaluating the reasonableness of defendants' actions. We find it reasonable for the defendants to make some effort to liquidate the take-or-pay obligations of AEC.

2. Third Party Beneficiaries.

Plaintiffs also sought relief as third party beneficiaries of GPC 5239. The Restatement defines third party beneficiaries as follows:

(1) Unless otherwise agreed between promisor and promisee, a beneficiary of a promise is an intended beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties and either

(a) the performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary; or

(b) the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance.

(2) An incidental beneficiary is a beneficiary who is
not an intended beneficiary. Restatement (Second) of Contracts, §302 (1981). The comments to this section provide no examples dealing with oil and gas leases.

Under the lease, the lessee's failure to perform will defeat the lessee's interest, so it follows that there is not a continuing obligation of performance, i.e. the lessee can abandon the lease. Nor does the lessee indicate by assignment of the lease that he intended to give the beneficiary any further benefit of promised performance. Therefore, it follows that the lessors are only, at the most, incidental beneficiaries and we affirm the trial court's dismissal of this claim.

3. Tortious Interference with a Contractual Relationship.

The next claim made is that of tortious interference with a contractual relationship between the lessor and the lessee. But, the leases are admittedly assignable, and the original lessee and transferor committed no unlawful act in exercising the right to assign. We affirm the trial court's dismissal of this claim.

4. Unjust Enrichment

This court's power extends to the equity aspects of this problem. U.S. Const. Art. III, § 2, cl. 1. The doctrine of unjust enrichment, that a person shall not be allowed to profit or enrich himself inequitably at another's expense is not contractual, but is equitable in nature. Black's Law Dictionary 1705 (4th ed. 1968).

"Take-or-pay" provisions in a lease are nothing new. See Southwestern Legal Foundation, Fourth Annual Institute on Oil and Gas Law and Taxation, 151, 170 (1953). It cannot be claimed by the defendant that the parties to this lease could reasonably foresee that, under the Natural Gas Policy Act of 1978, lessors would find their market shattered by the service of mandates issued by the
Federal Energy Regulatory Commission. In the course of those mandates, the market price of gas was determined not by the commercially logical principle of fitness of the gas for the purpose for which it was intended, but rather by an illogical principle related to the age of the wells.

The resulting market distortions forced the pipeline (AER) to take only the old gas, at a price level which the Federal Energy Regulatory Commission felt the customer would accept. The problems of lessor/royalty owners which arise with reference to take-or-pay clauses are generating substantial litigation as lessee/developers and marketer/pipeline owners, seek to resolve marketing problems created in the course of administration of the National Gas Policy Act of 1978 (NGPA), 15 U.S.C. §§ 3301-3432, which allowed gas price increases through supervised deregulation.

Three factors cry for equity intervention in this situation:


2. The artificial market distortion forced the pipeline, AER, to take the "old" gas and sell it at an artificial price to the consumers, and to abandon its efforts to honor the pay obligations.

3. Where before the purchase of Arkoma, its interest was consistent with that of the lessors, after AEC bought Arkoma its primary interest was with the pipeline, AER, because both were wholly owned by Arkla. Thus the lessors no longer had a representative dealing at arms-length with the pipeline. And lessors/royalty owners had no direct input into the making of the take-or-pay contracts since take-or-pay is a part of the developer/pipeline contract.
By its nature, gas can pass from one collection point in a reservoir to another, so a well, once opened, should be constantly tapped; and at the same time since gas is difficult and dangerous to store on the surface, and its users normally demand reliable, constant, access to it, both the developer and the pipeline want a constant flow.

As a result of the policies of the NGPA and the high demand for gas in the 1980's, and the inherent nature of gas, developers could, and did, get favorable take-or-pay provisions in their contracts. See, Kirk J. Brily, Comment, Royalty on Take-or-Pay Payments and Related Consideration Accruing to Producers, 27 Hous. L. Rev. 105 (1990).

But the NGPA developed the concept of "vintagizing" (i.e. classifying by the age of the wells), gas for purposes of producer price regulation that arose under the NGPA. "Old flowing gas" was held to price ceilings far below the market clearing price of gas. This pool of artificially low-priced gas has produced "horrendous" distortions of the gas market. And it was this distortion of market conditions, and efforts to adapt gas production contracts between developers and pipelines which generated the litigation before us now. See Richard J. Pierce, Jr., Lessor/Lessee Relations in a Turbulent Gas Market, 38th Oil and Gas Inst. § 8.04 (Matthew Bender 1987).

It is inevitable that as developers and pipeline marketers attempted to resolve problems of take-or-pay liabilities between themselves, the claims of royalty owners would arise.

In Mesa Petroleum Co. v. U.S. Dept. of Int., 647 F. Supp. 1350

2. Lessor Lessee Relations in a Turbulent Gas Market, 38th Oil & Gas Institute, 8.04 (Matthew Bender 1987).
(W.D. La. 1986), the Department of Interior, the royalty owner, claimed royalty on a take-or-pay payment that Mesa, the developer, had received from the pipeline. The court denied recovery, pointing out that the lease required "production" and the "pay" arose in an absence of production.

In *Diamond Shamrock Exploration Co. v. Hodel*, 86-536, slip op. (E.D. La. 1986), the United States District Court reasoned that the take-or-pay payments are intended to compensate the developer for costs necessary to keep the well functioning, so they fall within the definition of "production" as activities which take place after the successful completion of the well, such as operations, monitoring, and maintenance.

The case was appealed and reviewed in *Diamond Shamrock Exploration Co. v. Hodel*, 853 P.2d 1159 (5th Cir. 1988). The Circuit court rejected the Shamrock decision and held flatly that "[f]or purposes of royalty calculation and payment, production does not occur until the minerals are physically severed from the earth." *Id.* at 1168.

However, in January of 1988 the Outer Continental Shelf Lands Act (OCSLA) as administered by the Minerals Management Service, (MMS), revised its gas royalty evaluation regulation to provide:

"The value of gas . . . sold pursuant to an arm's-length contract shall be the gross proceeds accruing to the lessee." *Gross proceeds* are defined as "[t]he total monies and other consideration accruing to an oil and gas lessee . . . includ[ing] but . . . not limited to: Take-or-pay payments; . . . and other reimbursements. . . ." 30 C.F.R. 206.151 as quoted in Brily, *supra*. The author of that comment concludes, as to MMS' position that:

3. The 1992 CFR omits the words "take-or-pay payments".
The likelihood remains remote that a court will find that the MMS overstepped its bounds by declaring that take-or-pay receipts and other consideration accruing to the lessee give rise to a royalty obligation. The MMS's position appears neither arbitrary nor capricious. The most reasonable projection is that royalties will be due on federal lease take-or-pay payments in the future.

Brily, supra, at 122.

Wyoming, as to leases where the state is the lessor, has held, by analyzing the meaning of "production", that royalties are only payable when the oil or gas is severed from the earth. State v. Pennzoil Co., 752 P.2d 975 (Wyo. 1988).

In Louisiana, as to state leases, the State Mineral Board has adopted a resolution addressed to the take-or-pay issue and announced that all sums "attributable to gas contracts . . . should be paid to the state along with other royalties due."

Against this background of undertakings by governmental bodies to expand the scope of "royalty" by special definitions and concepts of "constructive" production, we turn back to the problem of leases between private parties, and an equitable analysis of the meaning of "royalty" and its impact on "take" funds under a take-or-pay contract.

The Louisiana mineral code, Article 213 provides that:

"Royalty" as used in connection with mineral leases, means any interest in production, or its value, from or attributable to land subject to a mineral lease, that is deliverable or payable to the lessor or others entitled to share therein. . . . "Royalty" also includes sums payable to the lessor that are classified by the lease as constructive production.

-15-
Arkansas statutory law has also addressed this problem of a fair distribution of the developers/lessees recoveries in performance of its duty to market. See Ark. Code Ann. §15-74-705 (Michie 1987). Arkansas law states:

It shall be the duty of both the lessee, or his assignee, and any pipeline company, corporation, or individual contracting for the purchase of oil or gas under any oil, gas, or mineral lease to protect the royalty of the lessor's interest by paying to the lessor or his assignees the same price including premiums, steaming charges, and bonuses of whatsoever name for royalty oil or gas that is paid the operator or lessee under the lease for the working interest thereunder.


The next line of cases involve four decisions arising out of the same case. For simplicity these cases will be cited as follows. The first decision, Frey v. Amoco Production Co., 708 F. Supp. 783 (E.D. La. 1989) will be referred to as Frey 1. The next in this group of cases, Frey v. Amoco Production Co., 943 F.2d 578 (5th Cir. 1991), will be referred to as Frey 2. The third, Frey v. Amoco Production Co., 951 F.2d 67 (5th Cir. 1992) will be referred to as Frey 3. The fourth decision, Frey v. Amoco Production Co., 603 So. 2d 166 (La. 1992) will be referred to as Frey 4.

In Frey 1, Amoco, the lessee/developer, sold gas from wells of Frey and others to Columbia, the pipeline/marketer. Columbia defaulted on its "pay" obligation. Amoco had sued Columbia in
Louisiana state court; and the case was settled by Columbia's payment to Amoco of:

1. Approximately $21 million as non-recoupable take-or-pay.
2. Approximately $45 million as recoupable payment.

The Royalty owner-lessees then sued Amoco in the United States District Court for a share of the settlement. Both sides moved for summary judgment. The court denied Amoco's motion and granted Columbia's motion. The court found that Amoco had paid royalty to Frey on all gas produced and sold. Amoco paid no royalty on payments made in settlement of Columbia's failure to keep up its take-or-pay payments. And, as to the recoupment taken by Columbia, Amoco had paid royalty at its standard rate, presumably below the contract value of the recouped gas. The court held that as to the non-recoupable payment, Frey, et al., had no claim because no gas had been produced and sold. And it held that Frey, et al., had no claim as to the recouped gas because they got the market value under the long term contract of sale and therefore had suffered no injury.

The case was appealed, Frey 2. The Fifth Circuit Court first distinguished Frey from Diamond Shamrock Exploration Co. using the lease language. In Shamrock the lessor received as royalty a fraction of the "amount or value of production saved, removed or sold." Diamond Shamrock Exploration Corp., 853 F.2d at 1163. But, in Frey 2 the lessor received a fraction of the "amount realized at
the well from the sale of gas." See Frey 2, at 581. Also, in Shamrock the court applied federal law to determine the meaning of the Department of Interior's lease then at issue; but in Frey 2 the court applied the law of Louisiana, and the Louisiana Supreme Court had not spoken to the issue.

The court then held that under the language "amount realized at the well from the sale of gas", production was not required under Louisiana law. The court further held, inter alia, take-or-pay payments are part of the "amount realized" from the sale of gas under the lease, and thus such payments received by the lessee in settlement of the take-or-pay dispute with its pipeline purchaser for gas not taken, are subject to the lessor's royalty. Frey 2 at 580-84. The court, relying on Louisiana law, reasoned that the payments "constitute economic benefits that Amoco received from granting Columbia the right to take gas from the leased premises, a right Amoco got through the lease. Id. at 584. It determined "it would be contrary to the nature of the lease as a cooperative venture to allow a benefit, by any name, that is attributable to the gas under the leased premises to inure exclusively to the lessee." Id.

The court also held that since the market value would vary during the period of recoupment, and the lessor's royalty share would vary with it, and since $45 million was paid for the recoupable gas, the volume of gas rather than the price per each thousand cubic feet (mcf) varied; and there was no problem of
computing the amount due the lessor's royalty interests.

On the take-or-pay issue the circuit court reversed the district court's summary judgment for Amoco and held the plaintiffs were entitled to their share of one-fifth of all take-or-pay payments received by Amoco. Id. at 586.

On a petition for rehearing, the circuit court in Frey 3 withdrew that portion of its opinion as to Frey's entitlement to a royalty interest on the take-or-pay settlement, and certified to the Louisiana Supreme Court this question:

Whether under Louisiana law and the facts concerning the Lease executed by Amoco and Frey, the Lease's clause that provides Frey a 'royalty on gas sold by the Lessee of one-fifth (1/5) of the amount realized at the well from such sales' requires Amoco to pay Frey a royalty share of the take-or-pay payments that Amoco earns as a result of having executed the Lease and under the terms of a gas sales contract with a pipeline-purchaser.

Frey 3 at 68.

The Supreme Court of Louisiana accepted the certification in Frey 4 after writing that:

The controversy centers around Frey's alleged entitlement to a royalty share of the $66.5 million in take-or-pay amounts paid by Columbia to Amoco under the Settlement Agreement. The parties characterized $45.6 million of the total as a "recoupable take-or-pay payment" and the remaining $20.9 million as a "non-recoupable take-or-pay payment."

Frey 4 at 170.

After recognizing the "fundamental principle that the lease contract is the law between the parties defining their respective
legal rights and obligations" it observed that "disinclined to write a mineral lease in pursuit of equity, we are nonetheless cognizant [that] the terms of a mineral lease are neither intended to, nor capable of, accommodating every eventuality." Frey 4 at 172. Further, the court observed:

When the parties made no provision for a particular situation, it must be assumed that they intended to bind themselves not only to the express provisions of the contract, but also to whatever the law, equity, or usage regards as implied in a contract of that kind or necessary for the contract to achieve its purpose.

Frey 4 at 172.

The court also pointed out that it cannot realistically be claimed that the lessor/royalty interest shares none of the costs or risks of development, and noted the risks of drainage and defective market forecasts are, for example, risks shared by the lessor/royalty interest. Id. at 178.

After finding that the Louisiana Mineral Code was not dispositive of lessor's right to take-or-pay payments, and that "... the terms of a mineral lease are neither intended to, nor capable of, accommodating every eventuality," it looked to the leasehold parties' general intent, i.e. that the lessor supplied the land and the lessor the capital and expertise necessary to develop the land for the mutual benefit of both parties. Id. at 172-73. In so doing it looked to 1) the function of the royalty clause and 2) to the lessor's implied obligation to market diligently the gas produced. Id.

The court adopted the principle that:

[A]ny determination of the market value of gas which admits the lessee's arrangements to market were prudently arrived at consistent with the lessee's obligation, but which at the same time permits either the lessor or the lessee to receive a part of the gross revenues from the
property greater than the fractional division contemplated by the lease, should be considered inherently contrary to the basic nature of the lease and be sustained only in the clearest of cases.

Henry v. Ballard & Cordell Corp., 418 So. 2d 1334, 1338 n.10 (La. 1982) (citing Thomas Harrell, Developments in Non-regulatory Oil & Gas Law, 30 Inst. on Oil & Gas L. & Tax'n, 311, 336 (1979)).

In further support of the proposition that royalty owners were entitled to share in take-or-pay monies and that the basic policy of the lease required a division of the total benefits, it observed that under a lease, as a bargained for exchange, the lessor would not relinquish a valuable right without receiving something in return. The take-or-pay contract gave the pipeline (AER) the right not to take gas as well as the right to take gas; and such a right had its price. Id. at 173. Further, almost invariably where take-or-pay claims are settled, there are amendments to other provisions of the (sale) agreement, particularly pricing and quantity provisions, for example, a lowering of the take obligations, even though the settlement agreement clearly allocates settlement payments between take-or-pay payments and modification of pricing provisions. (See 23 Tulsa L.J. No. 4 1988). The lessee's action has relinquished a valuable right and the lessor is entitled to receive something in return.

[Further, if producers are allowed to retain all of one part of the settlement (the lump sum payment), but must share with the royalty owners another part of the settlement (proceeds from future sales under the contract), producers have an artificial incentive to maximize the lump sum settlement and minimize future price.

Richard J. Pierce, Lessor/Lessee Relations in a Turbulent Gas Market, 38 Inst. on Oil & Gas Law & Tax'n 8-1, 8-20 (1987).

1. Professor Thomas Harrell, Professor of Oil and Gas Law, Louisiana State University Law Center, Baton Rouge, La.
The court in *Frey* 4 also found that the "amount realized" encompassed the contracted sale price of the gas per mcf, the amount paid in recoupable take-or-pay payment and in non-recoupable take-or-pay payments, and in settlement and release of the take-or-pay agreement. *Id.* at 179-80.

The writings in reference to this problem show a strong, developing recognition that a restrictive interpretation of the royalties clause in a conventional lease can be inconsistent with its basic purpose, and can produce results that are unintended by the parties, and unfair to the lessor. It is hornbook law that oil and gas leases are construed in favor of the lessor, if for no other reason than that the lessor is the uninformed and inexpert party to the bargain. *Summer’s Oil & Gas Perm Edition Vol. 2* at 372.

We also recognize the Harrell rule, that a lease arrangement is in the nature of a cooperative venture in which the lessor contributes the land and the lessee the capital and experience necessary to develop the minerals for the mutual benefit of both parties. And it follows from that rule that:

"...[A]ny determination[s] of the market value of gas which admits the lessee’s arrangements to market were prudently arrived at consistent with the lessee’s obligation, but which at the same time permits either the lessor or lessee to receive a part of the gross revenues from the property greater than the fractional division contemplated by the lease, should be considered inherently contrary to the basic nature of the lease and be sustained only in the clearest of cases."

*Harrell, supra,* at 336.

Nor is the Harrell analysis new or surprising. *See Biley, supra,* at 135. "...decisions that lessee owe royalties on non-recoupable payments... are legally and equitably sound." *Id.* The author supports the proposition that the royalty on recoupable payments should not be paid until gas is delivered at the well.
head. There the author recognizes the Hallard rule but seeks to follow the lease provision for capture where possible. See also, Pierce, supra, at § 8.03; John S. Lowe, Current Lease and Royalty Problems in the Gas Industry, 23 Tulsa L.J. 561; and Royalty Issues, Take or Pay Claims, and Division Orders, 24 Tulsa L.J. 511 et seq. Two cases applying the concept that all benefits grounded on the existence of a lease must be shared in accordance with the lease are Amoco Production Co. v. First Baptist Church, 579 S.W.2d 280 (Tex. Civ. App. 1979) and Henry v. Ballard & Cordell Corp., 418 S.W.2d 1334 (La. 1982) where Harrell is cited favorably, see 1335 n.10.


An implied covenant to market is discussed in Summer's, Oil and Gas, § 400 (1959). The writer's thesis is that, whether by specific language in the lease or by implied covenant, lessees have a clear duty to market oil and gas produced. In Ware, the Arkansas Supreme Court found five implied covenants in oil and gas leases. They are:

[1.] A covenant to drill wells within a reasonable time, testing the land for oil and gas;

[2.] a covenant to drill test wells within a reasonable time after notice;

[3.] a covenant, if oil and gas be found in paying quantities, to proceed with reasonable diligence in drilling sufficient number of wells to reasonably develop the premises;

[4.] a covenant to protect the land from drainage through wells on adjoining lands, by drilling offset wells; and

[5.] a covenant to market the produce of producing wells.

Ware, 602 S.W.2d at 624 (citing Summers, The Law of Oil & Gas, ch 13, §395 (vol. 2, 1959).
The test of compliance with an implied covenant is that of a reasonable developer. In this case, the trial court found that a valid claim of failure to market had been asserted, but that it was lost as time barred under Ark. Code Ann. § 16-56-105 (1987), the three year statute of limitations. However, based on the facts, we hold that the action is not time barred.

Ark. Code Ann. § 16-56-105 provides:

The following actions shall be commenced within three years after the cause of action accrues:

3. All actions founded on any contract or liability, express or implied;

The novation agreement between Arkoma and Arkla was formally executed on February 13, 1987. This action was brought by the filing of a complaint on February 23, 1990, three years and ten days later. The trial court held the three year statute applicable, found that the statute started to run when the novation occurred, and dismissed the suit as time barred by ten days. Appellants claim that it was not until March, 1987, when they received their January royalty checks, that they were put on notice of the change in their share. Appellees admit that they attempted to complete the novation of the take-or-pay contract as secretly as possible.

We recognize that the clear language of § 16-56-105 encompasses the oil and gas leases of appellants, including the implied covenant which is an integral part of such lease. The precise statutory language is "all actions founded on any contract or liability expressed or implied;". In Scroggin Farms Corp. v. Howell, 216 Ark. 569, 226 S.W.2d 562 (1950), the Arkansas Supreme Court observed that, "if the plaintiff, by reasonable diligence, might have detected the fraud he is presumed to have reasonable knowledge of it."

Appellants claim the statute did not begin to run until they
had or, by the exercise of due diligence, should have known, the facts that gave rise to their cause of action. We agree. The statute did not begin to run until late March, 1991, and the action is not time barred.

Summary judgment in favor of Jerral W. Jones and Michael V. McCoy on all issues is reversed. The denial of dismissal as to the issue of breach of the covenant to market is sustained. The dismissal of the action on the grounds that the action is barred by the statute of limitations is reversed, and the case is remanded to the trial court for further proceedings consistent with this opinion.

BRIGHT, Senior Circuit Judge, concurring.

I agree with the excellent discussion and opinion authored by Judge Van Sickle. I add these comments relating to the right of the lessors to share in the take-or-pay settlement proceeds which Jones and McCoy received.

As a general rule, oil and gas leases should be construed in manner so that the lessee and the lessor split all economic benefits arising from the land. Henry v. Ballard, 418 So. 2d 1334, 1338 (La. 1982); Harrell, Developments in Non-Regulatory Oil & Gas Law, The 30th Annual Institute on Oil and Gas Law Taxation, Southwestern Legal Foundation, 336 (1979). The fact that a lease conditions the receipt of royalties on the production, instead of the sale, of gas, should not annul a lessor’s right to receive proceeds from take-or-pay contracts. From an economic standpoint and for other reasons, a royalty should be due on take-or-pay payments or settlement. See Comment, The Lessor’s Royalty on Take-Or-Pay Payments and Settlements Under Gas Sales Contracts in Louisiana, 47 La. L. Rev. 589 (1987).
The express terms of the lessors' leases condition their receipt of royalties on the production of gas, and therefore they do not have a right to receive a share of a take-or-pay payment until production has occurred. This result is fair because the pipeline may eventually order delivery of additional gas under the contract to "make-up" for the earlier deficiencies. When this "make-up" gas is delivered, for which the pipeline has already paid under the "take-or-pay" clause, the lessee will pay the lessor his share of the value of that gas, which will approximate what the lessor would have gotten had he received a share of the "take-or-pay" payment.

However, in this case, the lessee and the pipeline terminated the gas-purchase contract and settled the pipeline's take-or-pay obligation with a lump-sum payment moving from the pipeline to the lessee. Because no future purchases were linked to that payment, under a strict reading of the lease, the lessors permanently lost their rights to receive a portion of the royalties from the settlement. Jones and McCoy may have reaped a substantial benefit from the lease that purported to be unrelated to the production of gas. This result would conflict with the underlying purpose of the lease, which is for the lessor to receive a share of all proceeds generated by the land, and may have resulted in Jones and McCoy receiving a potentially unjust enrichment. See Comment, Royalty on Take-or-Pay Payments and Related Considerations Accruing to Producers, 27 Houston L. Rev. 105, 134 n.225 (1990). Instead of viewing those proceeds as a windfall that the lessees (but not the lessors) received due to contractual maneuvering, a court should regard a lump-sum take-or-pay settlement as part of the proceeds arising from the sales of gas that previously had been produced under the contract. See Callery Properties, Inc. v. Federal Power Comm'n, 335 F.2d 1004, 1021 (holding that take-or-pay provisions generate proceeds from "sales" within the meaning of the Natural Gas Act, 15 U.S.C. § 717(b) (1964)). Essentially, the settlement could represent how much Arkla was willing to pay: 1) to be
released from the contract; and, in effect, 2) for the gas it has already received under the contract.

Thus, with regard to the lessors' unjust enrichment claim against Jones and McCoy, a substantial question of fact exists in this case as to whether, under the leases, the lessors had a right to receive a portion of the take-or-pay settlement that Arkla paid Jones and McCoy. If the lessors should have received a share of those proceeds, then Jones and McCoy were unjustly enriched, and they may have to share a portion of that "take-or-pay" settlement with the lessors.

A true copy.

Attest:

CLERK, U. S. COURT OF APPEALS, EIGHTH CIRCUIT.
[6] In sum, we do not decide either of petitioner's arguments for the writ because they were not raised below. We are aware that the petitioner labels this an original action in this court, and the petitioner might argue, on rehearing, that it is not necessary in an original action to have raised the issues before the trial court when the facts are undisputed. In some original actions the argument might be valid, but not when the petition is based on lack of venue. Monette Road Improvement Dist. v. Dudley, 144 Ark. 169, 222 S.W. 59 (1920).

Petition denied.


91-333

Supreme Court of Arkansas
Opinion delivered December 7, 1992

APPEAL & ERROR — PARTIES MUST ABSTRACT ESSENTIAL PORTIONS OF THE PROCEEDINGS — WITHOUT PROPER ABSTRACT, CHANCELLOR IS AFFIRMED. — Where there was no abstract, by either the appellants or the cross-appellants, of the complaint, the cross-complaint, or either of the answers, nor was there an abstract of the chancellor's findings of fact or the final order, the appellate court had no choice but to affirm the final order for failure of the parties to comply with Rule 9(d); it is necessary for a party to abstract the essential portions of the proceedings relied upon for appeal purposes.

Appeal from Franklin Chancery Court; Richard E. Gardner, Jr., Judge; affirmed.

Smith, Stroud, McClerkin, Dunn & Nutter, by: Hayes C. McClerkin and Barry A. Bryant, for appellants.
Turner & Mainard, by: Lonnie Turner, for appellees.

Robert H. Dudley, Justice. The chancellor cancelled the oil and gas leases to some of the vertical geological formations of a drilling unit. The defendant production companies appeal from the chancellor's finding that they have abandoned some of the formations, and the plaintiffs cross-appeal from the finding that the defendants have not totally abandoned the leases.

We cannot reach the merits of the case and must affirm the final order on both direct and cross-appeal for failure of the parties to comply with Rule 9(d) of the Rules of the Supreme Court and Court of Appeals. There is no abstract, by either the appellants or the cross-appellants, of the complaint, the cross-complaint, or either of the answers. An abstract of those pleadings would be helpful. There is no abstract of the chancellor's findings of fact or of the final order, and these are essential in order to understand this case. Equally critical are certain exhibits which are not abstracted or copied. The testimony of the witnesses about the exhibits is abstracted, but, without the exhibits, much of the testimony about the issues is meaningless.

[1] It is necessary for a party to abstract the essential portions of the proceedings relied upon for appeal purposes. Otherwise, all seven members of the court would have to pass, from office to office, the one transcript and the one set of exhibits in order to examine and understand the case, and, with the number of cases submitted, that is impossible. We have no alternative other than to do as we have done in other comparable cases and affirm the decree of the chancellor. See Hunter v. Williams, 308 Ark. 276, 823 S.W.2d 894 (1992); Meyers Gen. Agency v. Lavender, 301 Ark. 503, 785 S.W.2d 28 (1990); Cash v. Holder, 293 Ark. 537, 739 S.W.2d 538 (1987); and Zini v. Perciful, 289 Ark. 343, 711 S.W.2d 477 (1986).

Accordingly, we affirm pursuant to Rule 9(d).

Holt, C. J. and Brown, J., not participating.

Special Chief Justice Wright and Special Justice Ross concur.

Robert R. Wright, Special Chief Justice, concurring. I concur in this decision with great reluctance. I concur only
because Rule 9 of the Rules of the Supreme Court and Court of Appeals has been violated. It is my view that Rule 9 should be amended to provide that as soon as the problem has been discovered, the attorney involved be given thirty days in which to correct the problem by filling a new abstract or such missing documents as may present a problem. As it exists in its present form, Rule 9 is extremely harsh to litigants and lawyers alike. It is procedural in nature, but its application is punitive. The Rule should be amended as stated to ameliorate its harshness and to prevent injustice to those litigants whom it affects.

The situation in this case was such that the justices involved had to place great reliance upon the transcripts. There were five volumes, and I read most of them totally and some in part. I also examined the legal issues, involved in a number of cases, treatises, and law review articles. I felt qualified after that to render a judgment on the merits.

It is my opinion, in that regard, that the Chancellor would have been affirmed, at least in large measure, if the merits had been reached. Under those circumstances, the application of Rule 9 would seem to make little difference in the outcome. While there was conflicting testimony and evidence, this Court adheres to the proposition that the Chancellor will be affirmed unless his holding is clearly erroneous. If for no other reason, affirmance would probably have resulted even though I did not agree with him in some respects.

One thing that I would have commented on if the case had been decided on the merits is a rule in Arkansas oil and gas law that seems not to be the better rule and, in fact, is contrary to that of some of our neighboring, oil-producing states. In Arkansas, a new lessee can obtain a second lease from the lessor and then notify the first lessee that his lease is not any good due to the failure to drill. *Byrd v. Bradham*, 280 Ark. 11, 655 S.W.2d 366 (1983); S. Wright, *The Arkansas Law of Oil and Gas*, 10 U. Ark. Little Rock L.J. 699, 705 (1988). The better rule is that there should be a burden on the lessor to notify the lessee that if a well is not drilled within a certain reasonable period of time, the lease will be cancelled and there will be a new lessee. E. Kuntz, J. Lowe, O. Anderson, & E. Smith, *Oil and Gas Law* 287 (1986). The effect of non-drilling would not necessarily cancel the lease,
which would still be subject to the prudent operator standard and the implied covenant of reasonable development, but requiring notice might help to prevent litigation, which should be an object of the judicial system.

James A. Ross, Jr., Special Associate Justice, concurring. I concur in the results reached by the Court, but for different reasons. I would not affirm because of a failure to comply with Rule 9(d) of the Rules of the Supreme Court and Court of Appeals. However, based on the merits of the case, I would affirm the Decree of the Chancery Court of Franklin County on both direct appeal and cross-appeal.

Levonia GRAY v. STATE of Arkansas
CR 92-846
Supreme Court of Arkansas
Opinion delivered December 7, 1992

1. Criminal law — passenger found by trial court not to be an accomplice — remaining evidence clearly connected appellant to the crime. — Where the trial judge found that the passenger was not an accomplice, even though the police found him crouched down in the vehicle as they drove up to investigate, the appellate court could not say on that ambiguous circumstance that he was an accomplice as a matter of law.

2. Criminal law — evidence clearly connected appellant to the crime. — The remaining evidence connecting the appellant to the robbery was clear beyond any serious question — the clerk described the robber as a black male wearing white pants, camouflaged jacket and ski mask; two officers saw a man dressed accordingly enter and leave the store headed toward the parked vehicle containing papers belonging to the appellant; the ski mask was found some thirty feet from the car, as were tracks leading toward the car and then away from it; the clerk identified the appellant's voice as that of the robber; the evidence, though circumstantial, was entirely adequate to support the conviction.

Appeal from Pulaski Circuit Court; Jack L. Lessenberry,