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RECENT DEVELOPMENTS IN NATURAL RESOURCES LAW-CIRCA 1996
THOMAS A. DAILY

JUDICIAL DEVELOPMENTS

TAKE-OR-PAY SETTLEMENT ISSUES, INCLUDING ROYALTY
OWNER CLAIMS AND A SEVERANCE TAX DISPUTE, FILL THE JUDICIAL AIR

A number of cases were decided in 1996 which involved the right to share in
settlements of take-or-pay claims. Probably the most notorious of these reemerged under
the name of Klein v. Arkoma Production Co. The Eighth Circuit Court of Appeals heard,
for the second time, the class action case involving the take-or-pay deal that bought the
Dallas Cowboys. Here is the deal:

1. Jerral Jones and Michael McCoy owned Arkoma Production Company which had
a substantial take-or-pay claim against Arkla, Inc.

2. In a most creative settlement, Jones and McCoy sold all of Arkoma’s stock to
Arkla Exploration Company for a lot of money.

3. Arkla, Inc. then successfully negotiated with its new corporate subsidiary to
release the onerous contract containing the take-or-pay provision.

The class, composed of Cecil and Aetna Field royalty owners, sought a portion of the
purchase price paid to Jones and McCoy for the stock as the royalty share of a take-or-pay
buy out.

In its first ruling the Court of Appeals had reversed Judge Morris Arnold’s dismissal
of the class action based upon the statute of limitations. It agreed that Arkansas’ three year

1With considerable assistance from others including, without limitation, Tim Dowd
of Oklahoma City and Kevin Vaught of Fort Smith.


3Much has been said in conjecture about how Arkoma, Jones and McCoy
obtained the properties from which the take or claim arose in the first place. It will not
be repeated here.

4Then an Arkla Inc. subsidiary.

5980 F. 2d 521 (8th Cir. 1992).
statute on implied contract applied, but disagreed with Judge Arnold's commencement date of the period of limitations. In that ruling the Appeals Court also held that the Arkoma transaction gave rise to royalty liability. District Judge Jimm Hendren heard the case on remand. He held that the Eighth Circuit's "holding" that the sale of Arkoma's stock constituted, at least in part, a settlement of take-or-pay claims, was an "assumption" made by the Appeals Court, rather than a finding of law. Judge Hendren then concluded that the consideration paid for Arkoma was paid for the value of the company, rather than in settlement of the take-or-pay claim.

In its second opinion the Eighth Circuit Court stated clearly that its finding that the sale of the company was a settlement of the take-or-pay claims was indeed a conclusion of law and that it was binding upon the District Court as the "law of the case." The Court of Appeals went on to hold that the liability to royalty owners is primary as to Jones and McCoy and secondary as to Arkla.

The case is now before Judge Hendren on its second remand. He will attempt to determine what portion of the stock purchase price should be allocated to the take-or-pay settlement and then determine the allocation of damages among the class members, giving credit for those owners who are not entitled to share in the class' recovery. Don't be surprised by at least one more appeal.

While the Klein case is certainly notorious, it is not likely to be much of a precedent because its facts are so convoluted. In fact, most courts which have recently considered claims of royalty liability upon more straight-forward take-or-pay settlements have held against the royalty owners. Probably the most important of these cases is TransAmerican v. Finkelstein, in which the Texas Court of Appeals, en banc, withdrew its previous opinion which had allowed Finkelstein to share in TransAmerican's take-or-pay settlement on an equity theory similar to that of the Eighth Circuit Court of Appeals in Klein. In its

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6 A.C.A. § 16-56-105.

7 Judge Arnold had, by then, assumed a seat on the Eighth Circuit Court of Appeals.

8 Under a theory of unjust enrichment, because they got the money.

9 Under a theory of breach of the implied covenant to market gas upon favorable terms.

10 733 S.W. 2d 591 (Tex. App. San Antonio 1996)

11 That previous opinion is appended to the dissenting opinion beginning at 733 S.W. 2d 600.
rehearing the en banc court applied more traditional reasoning. It concluded that the lease contract provided for royalties to be paid on production of oil or gas and that no production could have occurred until oil or gas was severed from the ground. Thus, the Texas rule now appears to be that no royalties are due upon the payment of take-or-pay settlements until recoupment gas is produced, and if the settlement is non-recoupable, so that corresponding gas is never severed from the ground, no royalties are due at all. The case was a four-to-three decision and inspired a spirited dissent.

Unfortunately, before the en banc rehearing in *Finkelstein*, a United States District court, anticipating Mississippi law, had relied upon the earlier *Finkelstein* opinion, holding that Mississippi would follow Texas law and give royalty owners a share of non-recoupable take-or-pay settlement proceeds. In that case, *Williamson v. Elf Aquitaine, Inc.* the District Court went to great lengths to explain how Mississippi, absent controlling Mississippi case law, relies heavily upon Texas law for precedent in mineral law cases. Alas, the District Court was relying upon a Texas case whose opinion was about to be withdrawn.

The same issue was decided in Oklahoma in *Roye Realty v. Watson*. In that case the Oklahoma Supreme Court concluded that the authorities were split on the issue, but that the better rule was that royalties were due only upon production and that production required severance from the ground. Thus, the court denied the royalty owner's claim to a share of non-recoupable take-or-pay settlement proceeds.

Meanwhile, the Oklahoma Court of Appeals upheld the application of the Oklahoma gross production tax to a recoupable take or pay settlement, relying upon the language of the gross receipts tax statute. It also upheld the statute against constitutional challenge. So, in Oklahoma, royalty owners cannot share in take-or-pay settlements, but the State of Oklahoma can tax them.

Finally, the D.C. Circuit Court of Appeals held in *Independent Petroleum Association* 

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12Now withdrawn by the en banc opinion.

13925 F.Supp. 1163 (N.D. Miss. 1996)

14__P. 2d ___ (Okla. 1996)

15Similar to the Arkansas Severance Tax, but specifically taxing payments made as result of the purchaser's failure or refusal to purchase gas.

of America v. Babbitt\(^\text{17}\) that the Federal Government was not entitled to collect royalties on non-recoupable take-or-pay settlement payments at all, and that royalties on recoupable payments were not due until actual production of recoupment gas. This case is consistent with a previous Fifth Circuit ruling on similar facts,\(^\text{18}\) and is consistent with the recent Texas and Oklahoma decisions.

\(^{17}92\text{ F. 3d 1248 (D. C. Cir. 1996)}\)

\(^{18}\text{Diamond Shamrock Exploration Co. v. Hodel, 853 F.2d 1159 (5th Cir. 1988).}\)
In another important decision, the D. C. Circuit Court of Appeals upheld the F.E.R.C. ruling which had permitted Noram Gas Transmission Company to "spin down" its gas gathering facilities to a separate affiliate, Noram Field Services, and thus to operate the gathering facilities without F.E.R.C. regulation.\(^{19}\) Conoco and numerous intervenors\(^ {20}\) had challenged the F.E.R.C. determination that the gathering facilities were sufficiently "separate" to permit unbundling from the regulated facilities. The Court of Appeals not only permitted the spin-down and deregulation, it invalidated that part of the F.E.R.C. ruling which had required Noram Field Services to grant existing producers on the system a nondiscriminatory default gathering contract for an initial two year period. The Circuit Court held that F.E.R.C. was without authority to place such a condition upon its relinquishment of jurisdiction, while upholding F.E.R.C.'s approval of the "spin down."

ARKANSAS SUPREME COURT HOLDS THAT JURISDICTION TO ENJOIN
CONSTRUCTION OF A GAS PIPELINE IS IN CHANCERY COURT, NOT THE P.S.C.

Southwestern Gas Company v. Arkansas Louisiana Gas Corporation\(^ {21}\) involved a contract made by an independent gas producer\(^ {22}\) to sell gas directly to a glass manufacturing plant located within the city limits of Van Buren. Arkansas Oklahoma, the gas utility serving Van Buren, sued to enjoin the construction of the pipeline, citing a number of reasons why the injunction was in the public's interest. A temporary restraining order followed. The Chancery Judge then held a hearing on the continuance of the temporary restraining order and without warning converted the temporary restraining order into a permanent injunction.\(^ {23}\) On appeal the Appellants contended that only the Arkansas Public


\(^{20}\)One of these intervenors was Arkansas Royalty Membership.

\(^{21}\)325 Ark. 378, 925 S.W. 2d 164 (1996)

\(^{22}\)Fred Waelder.

\(^{23}\)Thus sending the case into a procedural tailspin from which it has not yet recovered. The Chancellor decided, upon remand, that the Supreme Court had determined that his hearing on the temporary restraining order was a trial upon the merits of the case and refused to permit Arkansas Oklahoma to introduce additional evidence justifying the injunction at the remand hearing. Notice of appeal has been filed from that ruling, so the Supreme Court will probably see the case again.
Service Commission had jurisdiction to enjoin the construction of a pipeline. The Supreme Court rejected this argument, holding that Chancery jurisdiction was proper. However, the Supreme Court ruled that there was insufficient evidence to justify the granting of the permanent injunction.

**ARKANSAS ROYALTY DEED CONSTRUED TO CONVEY A “FRACTIONAL SHARE” RATHER THAN A “FRACTION OF A SHARE”**

A year just wouldn't be a year without at least one decision construing an ambiguous South Arkansas royalty deed. 1996 was no exception. The case was *Parham v. Worthen Trust Company.*

The granting clause of the deed in question provides:

That we, Claude L. Smith and Helen E. Smith...grant, bargain, sell, convey, set over and assign and deliver unto the said I. L. and J. P. Cooper the following to-wit: An undivided 1/16 interest in and to all of the oil, gas and other minerals in the soil and under the surface thereof that may be produced from the land hereinafter described.

Unfortunately, other language in the deed confused the issue:

...said undivided 1/16 interest in the oil, gas and other minerals herein conveyed is to cover and apply to that portion only, which is 1/2 of 1/8 of the oil, gas and other minerals, reserved by the grantor herein, his heirs or assigns, in any lease for the development of oil, gas and other minerals now in existence, or that may hereafter be executed and delivered to any lessee...

And

...it being the intention of the parties hereto that this grant in no way shall prevent or interfere with the grant herein or his heirs or assigns in their own name to lease the land herein described for the purpose of developing for oil, gas and other minerals, the grant herein giving the grantee a mineral interest only to 1/16 of the oil, gas or other minerals to be delivered out of any royalty existing by virtue of any lease now on said land, or any that may be placed on said land by any party.

The Appellants, holding through the grantee of the deed, contended that this language mandated the conclusion that the conveyance was a “fraction of a share” royalty, entitling them to one-half of the one-sixth royalty on the new lease which the owner of the executory interest had negotiated. Their argument was not persuasive. The Arkansas Supreme Court agreed with the Appellees that the effect of the deed was to create a

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24 236 Ark. 754, ___ S.W. 2d ___ (1996).
"fractional share" royalty, fixed at one-sixteenth, regardless of the fractional royalty provided for in the subsequent lease.

This opinion was authored by Justice Andree Layton Roaf. It is quite well written, citing its reliance both upon Williams and Meyers Oil and Gas Law and upon professor Phillip Norvell's recent article on the subject of non-participating royalty interests.25

ARKANSAS JOINT TENANCY MAY BE DISSOLVED BY A CONVEYANCE FROM ONE CO-TENANT TO A STRANGER

Noland v. Noland26 involved a first conveyance by a mother and father to themselves and to two of their four adult children as joint tenants with right of survivorship and a later conveyance by the father to a family trust of the father's undivided interest, after the mother's death. The Chancellor had set aside the second conveyance upon alternate grounds. First, he held that the beneficiaries of the trust, having procured the second conveyance, had the burden of proving that the father was competent and that the conveyance did not result from undue influence from the beneficiaries. He held that the beneficiaries had failed to meet this burden of proof. Alternatively, the Chancellor held that a deed from one joint tenant to a stranger to the tenancy is a nullity.

The Arkansas Court of Appeals affirmed the result because it agreed with the Chancellor's analysis of the burden of proof issue. However, the Court specifically stated that the Chancellor was wrong about joint tenancy. The court recited the black letter rule of law that a conveyance from a joint tenant to a stranger is valid, but that it destroys the joint tenancy and results in a tenancy in common between the remaining former joint tenants and the stranger.

UNFENCED WELL IN URBAN AREA HELD "UNREASONABLY DANGEROUS" IN LOUISIANA CASE INVOLVING AN INJURY TO A CHILD WHO MAY HAVE BEEN PLAYING ON THE PUMP

Killough v. Bituminous Casualty Corp.27 involved a nine year old child who was seriously injured when his leg and foot became trapped in the pumping unit of a stripper oil well located near a school and playground in the town of Hosston, Louisiana. The child claimed to have been picking blackberries in the vicinity of the well and to have merely fallen into the pumping unit. The opinion belies suspicion that the child was, in fact, playing on the pump. The well, like almost all wells in the area, was not fenced. The Louisiana


27674 So. 2d 1091 (La. App. 1996).
Bench trial was held February 21, 22, 23, March 15, and April 6, 1995. The trial judge also made an on-site inspection of the accident site. In rendering judgment in favor of the plaintiff, the trial court found that the child was injured by the well pump in question. The court further found that the well site was open to the public without adequate warnings, safety barriers, or fences, and that such condition rendered it unreasonably dangerous. However, the trial judge stated his belief that the child was not entirely honest in his account of how the injury occurred and that the child was actually playing on the pump well when he was injured. Nonetheless, the trial court ruled that, based upon the totality of the evidence, the child was picking berries near the oil well “when he happened upon the well pump and perhaps in fact slipped.”

In assessing damages, the trial judge further noted that he was not overly impressed with the health care plan established by the plaintiff’s experts. The trial court awarded to the plaintiff damages of $230,736.08, subject to any applicable medical bill liens, plus legal interest from date of judicial demand; this sum included $155,000 for general damages.

The Court of Appeals generally upheld the trial court’s award, although it imposed a 10% comparative fault factor. The appellate court specifically agreed with the trial court that the mere existence of the unfenced well in this urban area was “unreasonably dangerous”.

PENNSYLVANIA SUPREME COURT CONSTRUES AMBIGUOUS RESERVATION IN DEED AS RESERVATION OF ALL OIL AND GAS

In the case of Sheaffer v. Caruso the Superior Court of Pennsylvania was called upon to interpret the following language in a conveyance:

EXCEPTING AND RESERVING from First Tract and Second Tract all the coal and mining rights and the oil and gas as fully as the same have been excepted and reserved or conveyed by former owners.

Relying heavily upon the grantor’s use of the word “RESERVING” in addition to the word “EXCEPTING”, the court held that this language reserved 100% of the oil and gas to the grantors instead of merely limiting their warranty as to a previously reserved one-third interest. While the deed’s language is highly ambiguous, this writer doubts that the grantor’s intention was to reserve minerals other than the one-third reserved by the prior owner. Obviously the Pennsylvania court thought otherwise. Indeed, that is what “ambiguous” means.

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28 676 A. 2d 204 (Penn. 1996)
CURRENT BRINE CASE SPOTLIGHTS STATUTE OF LIMITATIONS ISSUES

Some may be familiar with the currently raging controversy in South Arkansas over Smackover Formation brine containing relatively high concentrations of bromide salts. Part of this controversy involves lawsuits against Great Lakes Chemical Corporation alleging that tail brine from Great Lakes' salt water disposal wells invaded unleased lands of various plaintiffs, displacing valuable brine and causing damage actionable under the rule of Jameson v. Ethyl Corp.29 There are two such suits currently pending. The first, Deltic Farm and Timber Co., Inc. v. Great Lakes Chemical Corporation,30 involves the individual claim for damages of Deltic.31 The other case, Wooley, et.al. v. Great Lakes Chemical Corporation, et al32 seeks to become a class action brought on behalf of all formerly unleased owners within Great Lakes' three Union County brine production units33 recently formed by the Arkansas Oil and Gas Commission.34 In the Deltic case United States District Judge Harry Barnes has issued a partial summary judgment that Deltic's damages, if any, are limited to those sustained during the three years immediately preceding the filing of its complaint, because Arkansas law35 imposes a three year Statute of Limitations upon each of its several alleged causes of action.

Deltic had argued that Judge Barnes should impose the so-called "discovery rule" to the limitations issue so that the limitations period would not have commenced until Deltic actually knew or reasonably should have known about the alleged damage claim. Judge Barnes declined to apply the "discovery rule" under the circumstances, since Great Lakes' disposal and production activities were fully disclosed in public filings with the Oil and Gas Commission. He further held that, even if the "discovery rule" was applied, Deltic reasonably should have ascertained its alleged cause of action from public information available to it for more than three years prior to its commencement of the case.

29271 Ark. 621, 609 S.W. 2d 346 (1980).
31Until very recently Deltic was a wholly owned subsidiary of Murphy Oil Corporation.
32Case No. 96-302-2, Union County Circuit Court, 2nd. Div.
33Over 100,000 acres.
34A.O.G.C. Orders No. BU1-95 (South Plant Unit), BU2-95 (Central Unit) and BU3-95 (West Plant Unit).
35A.C.A. § 16-56-105.
Deltic sought and received Judge Barnes' permission to take an interlocutory appeal of this decision, and the Eighth Circuit Court of Appeals has now accepted the interlocutory appeal. The Court of Appeals is likely to decide the case in 1997. Obviously the issue involved has significance which goes well beyond the players in the case.

36 The cases is docketed in the Eighth Circuit as Case No. 97-1158WAED.
LEGISLATIVE DEVELOPMENTS

OKLAHOMA LEGISLATION PRESCRIBES SHAPE AND FONT OF RECORDABLE DOCUMENTS

In Oklahoma, unlike Arkansas, county clerks are required to maintain indexes of instruments affecting title to real property on a tract basis. These public officials are not without political power. In 1996 they persuaded the Oklahoma Legislature to prescribe a cure for a pet peeve. These people were tired of trying to index multi-tract documents, like blanket assignments of oil and gas leases, which sometimes contain exhibits listing hundreds of leases, in no particular order, in small print, if, indeed, they are legible at all. The result was Oklahoma House Bill 2796, enacted by the 1996 Oklahoma Legislature and signed by the Governor.

This law strictly prescribes the form for recordable instruments. It even regulates such matters as font size\(^{37}\) and margins.\(^{38}\) Even more of a potential problem is a requirement that legal descriptions referring to parts of governmental subdivisions must be to the nearest quarter section.\(^{39}\)

Oil and Gas producers and attorneys were unable to stop the passage of this act or to persuade Governor Keating to veto it. However, after it was signed, its enforcement was enjoined by a District Court judge in Oklahoma County. Hope is that it will be repealed.

\(^{37}\)Printed instruments must be in at least 12 point type, the font in which this paper is printed.

\(^{38}\)At least a one inch top margin and one-half inch bottom margin and side margins are mandated.

\(^{39}\)Arguably "the north half of Section 6" must be written "the northwest quarter and the northeast quarter of section 6."
or, at least, modified into something more reasonable.

**ALL EYES ARE ON LITTLE ROCK'S BIENNIAL LEGISLATIVE FOLLIES**

Watch out boys and girls, it's an odd numbered year. That means that the Arkansas Legislature is in session, whether it is needed or not. As of the printing deadline for this paper it is too early to report the final result of the Legislature's work. Much is going on. The author will try to keep up with it and report further when he delivers this paper to the Natural Resources Law Institute.

Currently pending bills include:

**BILLS RELATING TO THE ARKANSAS OIL AND GAS COMMISSION**


2. HB 1213. Biannual appropriation for A.O.G.C. This is sometimes a surprisingly controversial piece of legislation as individual representatives and senators vent the anger of their constituents against the Oil and Gas industry by taking it out on the Commission.

3. HB 1286. Would increase the stipend for A.O.G.C. Commissioners from $50 to $75 per meeting attended, plus expenses. Can these guys be trusted with that kind of money?

**BILLS RELATING TO LEASING OF STATE LANDS**

1. HB 1199. No state agency nor agent may lease state lands, including, presumably oil and gas leases, without the "advice" of the Legislative Counsel. If the Legislative Counsel does not advise within 45 days, the agency or agent may act without "advice." Tax forfeited lands are exempted. This bill, if passed will slow the procedure for obtaining a lease on state lands. It is hard to imagine a good reason for its passage. Obviously somebody leased some legislator's sacred cow without asking.

2. HB 1293. No lease mining or production of non-renewable resources from lands within state parks may be executed without approval at a state wide general election. This is an obvious overreaction to public outcry about commercial diamond mining in the Crater of Diamonds State Park. It could be a real problem if passed, because it will effectively make it impossible to form a drilling
unit which includes state park lands without an A.O.G.C. order "spacing-out" the lands. Such an order should, theoretically, include a finding that the state park lands would not be drained by unit operations, probably an untruth. This bill should never be passed. If it must be passed, it should be amended to exclude oil and gas leases with "no surface operations" clauses.

**OTHER BILLS OF INTEREST**

1. **HB 1127.** The Uniform Probate Code. This bill has failed to pass in previous sessions but has considerable support, primarily from the American Association of Retired Persons. It makes sweeping changes to probate law which are more than merely procedural. If it is enacted every landman and attorney working in Arkansas will have to be re-educated. It is not really a bad law, but there is considerable doubt whether it is really any better than the current Arkansas Probate Code.

2. **HB 1414.** This bill will prohibit the practice of releasing instruments by marginal notation after December 31, 1997. Marginal releases are already prohibited in those counties which do not have paper filing systems. Abstractors and title insurers would like to get rid of them altogether, as would landmen.