# RECENT DEVELOPMENTS IN KANSAS OIL AND GAS LAW (1983-1988)

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Kansas oil and gas law cases over the last five years covered a wide range of issues. These cases did not produce startling surprises or major aberrations, but they did produce significant discussion on several important topics.

## I. Construction Of Certain Lease Provisions

The duration of a basic oil and gas lease is prescribed by the habendum clause. The habendum clause typically states that the lease is to last for a specified number of years (the "primary term"), and then for so long thereafter as oil or gas is produced in paying quantities. To protect the lessee from termination of the lease for lack of production after the primary term, the lease typically includes lease-saving clauses. Under specified circumstances, these clauses will sustain the lease beyond the primary term despite a lack of production. One of these lease-saving clauses is the operations clause, which typically states: "If the lessee shall commence to drill a well within the term of this lease or any extension thereof, the lessee shall have the right to drill such well to completion with reasonable diligence and dispatch."[1]

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1. This is an example of a well-completion clause, which is one of two common types of operations clauses. The operations clause generally provides that the lease will continue in effect beyond the primary term so long as drilling operations continue on the premises, even if production has not yet resulted. The continuous operations clause (sometimes referred to as the continuous drilling operations clause) allows the lessee to continue the lease by operations that are different and independent from activities that were in progress when the primary term expired. The well-completion clause (sometimes referred to as the drilling operations clause), however, sustains the lease only for so long as the lessee continues operations on the same well that was in progress when the primary term expired.

Three cases from the survey period[2] involved the application of the operations clause. One of the basic requirements of the typical operations clause is that the lessee must have "commenced" operations prior to the end of the primary term.[3] In two of the three cases,[4] the lessors challenged whether the lessees met this requirement. The lessors argued that because the lessees had not commenced operations prior to the end of the primary term, the lessees were not entitled to the benefit of the operations clause, and therefore the lease had terminated for lack of production. Courts from other jurisdictions are generally flexible and liberal in finding that commencement has occurred in this situation,[5] but the Kansas courts apparently favor a narrower construction.

In *Herl v. Legleiter*,[6] the lessee undertook certain preparatory activities prior to drilling. The lessee argued that these activities constituted commencement of a well. Spudding of the earth had not yet occurred by the end of the primary term; indeed, no drilling rig had been moved onto the premises prior to the end of the primary term. However, an access road had been constructed, the location had been staked, pits had been constructed, drilling mud had been delivered to the well site, and stem and casing pipe had been made available to the well site. The prime issue was whether these activities constituted commencement of drilling sufficient to sustain the lease beyond the primary term, thereby extending the time within which to make the well productive. The court of appeals referred to prior Kansas cases that were apparently willing to accept something less than actual spudding as commencement.[7] In the court's view, however, the lessee fell short of commencement by failing to secure a drilling rig for the premises by the end of the primary term. The lessee did not own a rig or have access to one. The lessee had entered into preliminary negotiations with a drilling company but had not acquired a firm

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2. Adolph v. Stearns, 235 Kan. 622, 684 P.2d 372 (1984); A & M Oil, Inc. v. Miller, 11 Kan. App. 2d 152, 715 P.2d 1295 (1986); Herl v. Legleiter, 9 Kan. App. 2d 15, 668 P.2d 200 (1983).

3. *See generally* R. HEMINGWAY, THE LAW OF OIL AND GAS § 6.7 (2d ed. 1983).

4. *A & M Oil, Inc.* 11 Kan. App. 2d at 152, 715 P.2d at 1295; *Herl*, 9 Kan. App. 2d at 15, 668 P.2d at 200.

5. *See generally* 3 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 618.1 (1988) ("in general it appears that the courts have been ready to find the commencement of operations (or the pursuit of drilling operations) where only the most modest preparations for drilling have been made").

6. 9 Kan. App. 2d 15, 668 P.2d 200 (1983).

7. *Id.* at 18-19, 668 P.2d at 203 (citing Shoup v. First Nat'l Bank, 145 Kan. 971, 67 P.2d 569 (1937); Phillips v. Berg, 120 Kan. 446, 243 P. 1054 (1926); Henning v. Wichita Natural Gas Co., 100 Kan. 255, 164 P. 297 (1917)).

commitment or a written contract. The court did not state whether such a commitment or contract would have made a difference. The court held only that the lessee's activities were insufficient to constitute commencement by the end of the primary term.[8]

Even if the lessee commences operations before the end of the primary term, the operations clause sustains the lease beyond the primary term only for so long as the lessee continues operations with due diligence.[9] The court in *Herl v. Legleiter* observed that the lessee had conducted no activity whatsoever after the primary term.[10] Thus, not only had the lessee failed to commence operations by the end of the primary term, but he also failed to perform with due diligence after the primary term. The lessee therefore could not properly invoke the operations clause to sustain his lease.

The court of appeals again considered an operations clause in *A & M Oil, Inc. v. Miller.*[11] *A & M Oil, Inc.* presented the unusual question of whether the lessee commenced drilling on the leased premises by drilling a slant well on the adjacent premises. Although the lessee intended from the outset that the leased premises be the ultimate destination of the drilling operation, the drill bit did not penetrate the leased premises until after the primary term ended. The lessee had received authority from the city and a permit from the Kansas Corporation Commission allowing it to drill directionally and had drilled more than one thousand feet before the expiration of the primary term. The court held that commencement occurred prior to the end of the primary term, even though no tangible activity occurred on the leased premises until after the primary term had expired.[12] This result seems consistent with the general attitude of most courts, which perceive the commencement of drilling operation as "any work or actual operations undertaken or commenced in good faith for the purpose of carrying out any of the rights, privileges or duties of the lessee under a lease. . . ."[13]

The Kansas Supreme Court considered a similar clause in *Adolph v. Stearns.*[14] The habendum clause stated that the lease would continue beyond the primary term for as long as production took place or for as long as the premises were "being developed or

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8. *Herl*, 9 Kan. App. 2d at 19, 668 P.2d at 203.
9. *Id.* at 18, 668 P.2d at 203.
10. *Id.*
11. 11 Kan. App. 2d 152, 715 P.2d 1295 (1986).
12. *Id.* at 154-55, 715 P.2d at 1297.
13. 3 H. WILLIAMS & C. MEYERS, *supra* note 5, § 618.1.
14. 235 Kan. 622, 684 P.2d 372 (1984).

operated." The court, applying a mathematical or objective test,[15] held that production in paying quantities[16] had not occurred in view of the well's substantial salt water production and limited oil production.[17] The lessees, however, pointed to the second part of the habendum clause, arguing that the lease was extended by their efforts in developing and operating the premises. The Kansas Supreme Court rejected the lessees' argument.[18] The court first superimposed on the express language of the habendum clause the implied requirement that the lessees' operations be conducted with diligence and in good faith.[19] The court then addressed whether the lessees' activities in this case met the implied requirement. Noting that the tangible results of the lessees' efforts were substantial amounts of salt water and very little oil and that the only prospects for production were "unassured,"[20] the court suggested that the lessees' continued efforts would not have been in good faith because the efforts apparently were for the sole purpose of sustaining the lease rather than achieving production.[21] Although curtailing drilling activity may have been economically prudent for the lessees,[22] the lessees' operations did not meet the requirements of the habendum clause. The court concluded that the lease had been properly terminated.[23]

In other cases during the survey period, the Kansas courts construed and applied various lease clauses other than the opera-

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15. *Id.* at 627, 684 P.2d at 377. In Reese Enters., Inc. v. Lawson, 220 Kan. 300, 553 P.2d 885 (1976), the Kansas Supreme Court opted to apply an "objective test" to the question of whether the lessee had produced in paying quantities: "In our opinion the better approach is to follow the innumerable cases which apply an objective test, where the determination of 'paying quantities' turns upon a mathematical computation." *Id.* at 313-14, 553 P.2d at 897. The court rejected the "subjective approach" articulated by the Texas case of Clifton v. Koontz, 160 Tex. 82, 89, 325 S.W.2d 684, 691 (1959) ("the standard by which paying quantities is determined is whether or not under all the relevant circumstances a reasonably prudent operator would, for the purpose of making a profit and not merely for speculation, continue to operate a well in the manner in which the well in question was operated").

16. The lease stated, in part, that it would continue in effect for as long as oil or gas was "produced" and did not expressly require that the production be in "commercial quantities" or in "paying quantities." Consistent with prior Kansas cases, the court construed the clause to require production in paying quantities. *Adolph*, 235 Kan. at 626-27, 684 P.2d at 376. *See* Texaco, Inc. v. Fox, 228 Kan. 589, 618 P.2d 844 (1980).

17. *Adolph*, 235 Kan. at 626-27, 684 P.2d at 377.

18. *Id.* at 629, 684 P.2d at 378.

19. *Id.* at 628, 684 P.2d at 377.

20. *Id.* at 629, 684 P.2d at 378.

21. *Id.*

22. *Id.* at 626, 684 P.2d at 376.

23. *Id.* at 629, 684 P.2d at 378.

tions clause. In *Brubaker v. Branine*,[24] the court considered the interplay between an entirety clause and a notice-of-assignment clause. The entirety clause anticipates that the lessor may, subsequent to execution of the lease, assign divided portions of the leased premises. The entirety clause[25] negates the Kansas common-law nonapportionment rule,[26] which states that production generates royalties only for the owner of the particular subdivision where the production occurs.[27] Under the typical entirety clause, all subdivision owners share the royalties, regardless of the particular well's location. The notice-of-assignment clause addresses the situation in which the lessee, following a total or partial assignment of the lessor's interest, may be unaware that different parties are now entitled to receive delay rentals and royalties.[28] The notice-of-assignment clause provides that the lessee is entitled to rely on the prior ownership status until the lessee receives notice, in accordance with some prescribed procedure, of the assignment.

The lease in the *Brubaker* case contained both an entirety clause and a notice-of-assignment clause. The lessee, unaware of the defendants' partial conveyance of the leased premises to the plaintiffs, continued to pay the defendants the full royalty from production occurring on the premises retained by the defendants. The court held that these payments did not constitute conversion by either the lessee or by the defendant, but rather was a breach of a written contract (*i.e.*, the assignment agreement and the original lease to which it applied) by the defendant. Consequently, the five year statute of limitations for breach of contract governed, and the plaintiffs were entitled to an accounting under the written contract.[29] The court further held that the plaintiffs had a cause of action only against the assignors and not against the lessee. The lessee would have been liable had the lease not contained a notice-of-assignment clause or had the lessee been properly notified in accordance with the notice-of-assignment clause. But under the

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24. 237 Kan. 488, 701 P.2d 929 (1985).

25. The entirety clause stated:

> If the leased premises are now or hereafter owned in severalty or in separate tracts, the premises, nevertheless, may be developed and operated as an entirety, and the royalties shall be paid to each separate owner in the proportion that the acreage owned by him bears to the entire leased area.

*Id.* at 489, 710 P.2d at 930-31.

26. *See* Carlock v. Krug, 151 Kan. 407, 99 P.2d 858 (1940).

27. 2 H. WILLIAMS & C. MEYERS, *supra* note 5, § 520.

28. *See generally* 3 H. WILLIAMS & C. MEYERS, *supra* note 5, § 606.4; 4 H. WILLIAMS & C. MEYERS, *supra* note 5, § 677.4.

29. *Brubaker*, 237 Kan. at 492-93, 701 P.2d at 933.

facts of the case, the notice-of-assignment clause operated as an effective defense for the lessee.[30] Thus, the benefit of a notice-of-assignment clause for lessees is similar to the benefit that a division order provides for purchasers, who can avoid liability for incorrect payments by paying in accordance with the division order.[31]

Kansas courts also construed a cheap gas clause contained in a gas storage lease. The lessor in *Richardson v. Northwest Central Pipeline Co.*[32] had subdivided the premises subsequent to leasing and sold a portion of the premises to a party whose successors further subdivided the parcel. Owners of one of the subdivisions later requested permission from Northwest, the owner of the gas storage lease, to connect to its gas pipeline for the purpose of receiving cheap gas for domestic use. Northwest acceded to this request but denied all other similar requests. The *Richardson* issue was whether the cheap gas clause obligated the lessee to provide free gas for more than one principle dwelling. The phrase "principle dwelling house" did not appear in the critical provision of the lease, although it appeared at other points in the lease. The lease did refer to "a meter," rather than to more than one meter, which indicated that use would be limited to one dwelling. The court, after noting that the clause was ambiguous, determined that the parties could not have intended that cheap gas be provided to an unlimited number of subdivisions. The language of the clause did not support this multiplication of the lessee's commitment. The court concluded that the clause entitled only the owner of the lessor's principle dwelling to the cheap gas.[33]

In *Cherokee Resources, Inc. v. Gold Energy Corp.*,[34] the Kansas Court of Appeals interpreted a guaranteed royalty clause of a lease in which the lessee had subdivided the leasehold interest. All wells were located on the portion assigned. Production was insufficient to generate the minimum royalty, and the assignee Gold Energy Corp. therefore satisfied the difference. The issue was whether the guaranteed royalty clause obligated the assignor Cherokee Resources to contribute a proportionate share of the guaranteed royalty payments, based on its retained acreage. Gold argued that the minimum royalty was actually rent, not royalty, because royalties are part of minerals actually produced. Thus, Gold argued, this "minimum royalty" should be apportioned on an acreage

30. *Id.* at 493, 701 P.2d at 933.
31. *See* R. HEMINGWAY, *supra* note 3, § 7.5.
32. 241 Kan. 752, 740 P.2d 1083 (1987).
33. *Id.* at 760, 740 P.2d at 1088.
34. 11 Kan. App. 2d 436, 724 P.2d 695 (1986).

basis because the lease contained a proportionate rent clause. This clause stated that each party was responsible for its proportionate share of rentals and that any party's failure to pay its share would affect the lease only with regard to that party's acreage.[35]

The court could have rejected Gold's argument on the ground that the proportionate rent clause did not create contractual responsibility between Cherokee Resources and Gold. The court chose instead to regard the payment as royalty, not rent, thus rendering the proportionate rent clause inapplicable.[36] The court viewed the payment as a royalty because it was in lieu of actual royalty, rather than to defer drilling operations.[37] The court concluded, however, that Cherokee Resources was obligated to contribute its proportionate share, based on equitable principles.[38] Although the court supported its conclusion with no more than a brief reference to equity,[39] the result seems to be correct.

## II. THE RULE OF CAPTURE

The rule of capture generally entitles landowners to all the minerals produced from wells drilled on their own property, even if part of the production migrated from neighboring tracts.[40] This principle encourages producers to engage in full activity and rewards their efforts because it protects them from potential liability for trespass or conversion when drainage occurs.[41] The rule of capture modifies the ad coelum doctrine[42] and recognizes the mobile nature of oil and gas.[43] The rule of capture itself has been modified in some respects, most notably by the doctrine of correlative rights[44] and by state regulation.[45]

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35. The purpose of this clause would be to negate the general rule of indivisibility of express lease covenants. Under this general rule, a lease with an unless-type delay rental clause is not sustained, even partially, when a partial assignee of the lease rights pays only its proportionate share of delay rentals. 2 H. WILLIAMS & C. MEYERS, *supra* note 5, § 407.1.

36. *Cherokee Resources*, 11 Kan. App. 2d at 438, 724 P.2d at 698.

37. *Id.* at 439, 724 P.2d at 698 (citing R. HEMINGWAY, *supra* note 3, § 7.6).

38. *Id.* at 439-40, 724 P.2d at 698.

39. *Id.*

40. Prewett v. Van Pelt, 118 Kan. 571, 576, 235 P. 1059, 1061 (1925); Lanyon Zinc Co. v. Freeman, 68 Kan. 691, 696, 75 P. 995, 997 (1904).

41. *See generally* 1 E. KUNTZ, A TREATISE ON THE LAW OF OIL AND GAS § 4.1 (1987).

42. "The doctrine that ownership of land extends from the heavens to the core of the earth: *cujus est solum, ejus est usque ad coelum et ad inferos*." 8 H. WILLIAMS & C. MEYERS, *supra* note 5, § 204.

43. 1 E. KUNTZ, *supra* note 41, § 4.1.

44. "The right of the individual owner to take oil and gas from the reservoir in lawful operations is limited only by a duty to other owners (1) not to injure the source of supply

The rule of capture was adopted from the law of wild animals, and courts applied the rule in early cases involving oil and gas.[46] The rule of capture was early qualified by the notion that a person's rights to a captured animal were forfeited by the escape or release of the animal.[47] A similar question with gas occurs when producers restore produced gas to an available formation beneath the surface for storage purposes when no market for the produced gas is immediately accessible. The issue then arises whether the gas once again becomes fair game for capture by a neighboring tract owner whose land overlies the storage area.

Courts in other jurisdictions have taken divergent views on this issue. The Kentucky rule is represented by *Hammonds v. Central Kentucky Natural Gas Co.*,[48] which held that the producer lost its rights to produced gas by reinjecting the gas into the ground. Because the original producer no longer owned the gas, the Kentucky rule relieved the producer from liability for trespass.[49] Thus, the Kentucky rule benefited the original producer in that case. The Texas rule, illustrated by *Lone Star Gas Co. v. Murchison*,[50] is that "the owner of gas does not lose title thereof by storing the same in a well-defined underground reservoir."[51]

The Kansas Supreme Court faced this issue in *Anderson v. Beech Aircraft Corp.*[52] and sided with the *Hammonds* position, holding that Beech lost its ownership of produced gas by injecting it into an underground reservoir for storage purposes.[53] The court referred to the law of wild animals and to the principle that "when restored to their natural wild and free state, the dominion and individual proprietorship of any person over them is at an end and they resume their status as common property."[54] In the court's

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and (2) not to take a disproportionate part of the oil and gas." Kingwood Oil Co. v. Corporation Comm'n, 396 P.2d 1008, 1010 (Okla. 1964).

45. *See generally* D. PIERCE, KANSAS OIL AND GAS HANDBOOK § 3.05 (1986).

46. *E.g.*, People's Gas Co. v. Tyner, 131 Ind. 277, 31 N.E. 59 (1892).

47. *See* Mullett v. Bradley, 24 Misc. 695, 53 N.Y.S. 781 (Sup. Ct. 1898); R. BROWN, PERSONAL PROPERTY § 2.5 (3d ed. 1975).

48. 255 Ky. 685, 75 S.W.2d 204 (1934).

49. According to Anderson v. Beech Aircraft Corp., 237 Kan. 336, 345-46, 699 P.2d 1023, 1030 (1985), it appears that the common law of Missouri and Oklahoma agrees with the *Hammonds* view, although both states have statutes that provide for the condemnation of underground reservoirs for the storage of natural gas. MO. ANN. STAT. § 393.500 (Vernon Supp. 1985); OKLA. STAT. ANN. tit. 52, § 36.6 (West 1969).

50. 353 S.W.2d 870 (Tex. Civ. App. 1962).

51. *Id.* at 879.

52. 237 Kan. 336, 699 P.2d 1023 (1985).

53. *Id.* at 348, 699 P.2d at 1032.

54. *Id.* at 343, 699 P.2d at 1029 (referring to *Hammonds*).

view, any other approach to this issue should be instituted only by the legislature, as has occurred in other states.[55]

The *Anderson* result provides a clear rule and potentially relieves the courts from certain difficult decisions, such as whether the particular storage reservoir is "well-defined" as postulated by the *Lone Star* court.[56] The *Anderson* decision is regrettable, however, in several respects. At a conceptual level, the reinjection of gas is not equivalent to releasing a wild animal. The *Hammonds* court asserts that the reinjection of gas is analogous to releasing a fish into a stream.[57] A better analogy, however, would be to confine the fish within a private pond, in which case possessors would not have abandoned their rights to the fish.[58] The clear intent to retain possession and the comparative ease of retrieval should mark the property as remaining under the control of the initial possesor.

Moreover, for policy reasons, it should be recognized that gas is often an unavoidable, but not necessarily unwelcome, result of oil production, and that storage in the ground, although not common, is generally a safe and economically efficient means of controlling such gas until a market becomes reasonably available. To hold that this method of storage results in forfeiture of the producer's rights may prompt producers simply to waste the gas

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55. *Id.* at 348, 699 P.2d at 1032. The court briefly described statutes enacted in other states to regulate the underground storage of natural gas:

> These statutes vary widely in their provisions. The Washington (Wash. Rev. Code Ann. § 80.40.050 [Supp. 1985]), Georgia (Ga. Code Ann. § 46-4-57 *et seq.* [1982]), Louisiana (La. Rev. Stat. Ann. § 30-22 [West 1975]), and Colorado (Colo. Rev. Stat. 34-64-101 *et seq.* [1984]) statutes provide for the condemnation of underground reservoirs for the storage of natural gas. Those state statutes provide that the injected gas shall remain the property of the injector but preserve the rights of owners to drill through the underground reservoir. The Missouri statute (Mo. Ann. Stat. § 393.500 [Vernon 1985 Supp.]), and the Oklahoma statute (Okla. Stat. Ann. tit. 52, § 36.6 [West 1969]) provide that the gas remains the property of the injector, ***but such rule is not applied to a person whose land is not acquired.*** In the latter instance, it appears that both Missouri and Oklahoma have adopted the rule that such injected gas becomes subject to the law of capture if it migrates from the contained area. The New Mexico act (N.M. Stat. Ann. § 70-6-8 [1978]) also contains the exceptions presented in the Missouri and Oklahoma statutes. These various statutes are cited in order to show the wide variations in the legislative policy governing the creation of underground gas storage facilities and the condemnation of land for that purpose.

*Id.* at 345-46, 699 P.2d at 1030 (emphasis in original).

56. *See, e.g.*, Ellis v. Arkansas Louisiana Gas Co., 450 F. Supp. 412, 419 (E.D. Okla. 1978), *aff'd*, 609 F.2d 436 (10th Cir. 1979), *cert. denied*, 445 U.S. 964 (1980) ("This court's decision in this case is limited to a circumstance where the reservoir is defined and there is no commingling between economically recoverable native gas and injected gas.").

57. *Hammonds*, 255 Ky. at 689-90, 75 S.W.2d at 206.

58. *Id.* at 690, 75 S.W.2d at 206.

or discourage them from producing it in the first place. The better rule would sustain the producer's rights so long as the storage area is sufficiently defined to establish intent to retain and relative ease of retrieval. Such a position would be consistent with the fundamental purpose of the rule of capture, which is to encourage and reward diligent and productive behavior.[59]

## III. OPERATORS' CONFLICTS WITH SURFACE OWNERS

Perhaps no relationship in the production of oil and gas generates as much conflict as the relationship between operator and surface owner. The survey period produced considerable discussion on this issue. The owner of a severed mineral rights interest is generally entitled to enter onto the surface and to use it as is reasonably necessary to explore, remove, and market the minerals.[60] The oil and gas lessee is in a similar position.[61] If the operator's activities are within the bounds of reasonable use, the operator generally has no responsibility to restore the surface or to compensate the surface owner for damages to the surface.[62] The operator's rights arise by implication and may be limited by express language in the mineral deed or lease.

A typical example of the conflict between surface owner and operator is presented by *Thurner v. Kaufman*.[63] In *Thurner*, the lessors alleged that the lessees breached an express lease provision requiring the lessees to install steel or aluminum gates to prevent the escape of livestock at the lessees' access points. The lessors also claimed that the lessees failed to fence their oil pits and tank battery and permitted a major oil spill to occur. As a result, several of the lessors' cattle escaped or were injured. In addition, the lessees allegedly damaged the land by dumping salt water onto it. There was no question that the lessees breached the express pro-

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59. 1 E. KUNTZ, *supra* note 41, § 4.1.

60. *See generally* 1 H. WILLIAMS & C. MEYERS, *supra* note 5, § 218.7.

61. *See generally id.*

62. *See* Decker v. Jones, 194 Kan. 146, 398 P.2d 325 (1965) (lessee required by statute upon abandonment of lease to restore premises to original condition; otherwise, lessee generally under no duty, in the absence of a statute or lease provision to the contrary, to restore premises to original condition). Not all jurisdictions agree. *See generally* 1 H. WILLIAMS & C. MEYERS, *supra* note 5, § 218.12. *See also* KAN. STAT. ANN. § 55-177 (1988 Supp.) (lessee required, within six months after abandonment of oil and gas well, to remove all operating equipment from the premises and to grade the surface so as to leave the land in the same condition as it was when the operations commenced); Annotation, *Duty of Oil or Gas Lessee to Restore Surface of Leased Premises Upon Termination of Operations*, 62 A.L.R.4TH 1153 (1988).

63. 237 Kan. 184, 699 P.2d 435 (1985).

visions of the lease.[64] Much of the court's analysis, however, focused on the lessees' general negligence, independent of any express lease provisions. The court especially focused on the "overflow of pollutive substance upon the land," which the court characterized as a "common situation where courts have found liability based on negligence."[65] The court recognized the lessees' "implied right to make reasonable use of the surface in order to develop the land for the oil and gas," but also noted that when the lessees' activities exceed the bounds of reasonableness and become "injurious to the lessors' agricultural pursuits, courts have displayed great willingness to step in and impose liability despite the lack of any express provision."[66] The lessees' flagrant violations of the express lease provisions alone were a sufficient basis for awarding the remedy of forfeiture of the lease. The court termed the express provisions "an 'essential' part of the lease" and concluded that forfeiture is an appropriate remedy when these express provisions are "so flagrantly violated as to deny the lessors the use of the surface rights retained, thereby denying the lessors the right to pursue farming operations which are the lessors' means of livelihood."[67]

To help define more explicitly the scope of the lessee's rights to use the surface, as well as to protect the landowner's interests, the lease commonly contains language that holds the lessee responsible for damage to "growing crops." Interpretation of this phrase in turn generates controversy. In *Trotter v. Wells Petroleum Corp.*,[68] the court held that the phrase "growing crops" did not refer to native pasture because the pasture had not been "seeded, fertilized, or otherwise tended."[69] The court apparently agreed with cases from other jurisdictions that limited "growing crops" to crops resulting from human effort, therefore excluding native grasses.[70] The court suggested, however, that the clause might be construed to include pasture grass if the entire leased premises are uncultivated pasture. In such a situation the parties presumably intend that the phrase refer to the native grass. But half of the tract in the *Trotter* case was cultivated, making it likely, in the court's view, that the parties intended the phrase "growing crops" to include only the cultivated crops.[71]

64. *Id.* at 186, 699 P.2d at 437-38.
65. *Id.* at 188, 699 P.2d at 438.
66. *Id.* at 188, 699 P.2d at 439.
67. *Id.* at 189, 699 P.2d at 439.
68. 11 Kan. App. 2d 679, 732 P.2d 797 (1987).
69. *Id.* at 683, 732 P.2d at 800.
70. *Id.* at 681-83, 732 P.2d at 799-800.
71. *Id.* at 683, 732 P.2d at 800.

Other authorities indicate that the phrase "growing crops" is more likely intended to exclude native pasture when the same clause also requires the lessee to bury its pipe lines "below plow depth."[72] The apparent belief is that the proximity of the two phrases shows that the parties' main concern was to protect agricultural pursuits.[73] The lease in *Trotter* contained the plow-depth requirement, although not in the same sentence that referred to "growing crops." The *Trotter* court regarded this as "some support" for the lessee's position because the crop damage clause was "within two sentences of a reference to 'plow depth'", but the court declined to find this determinative "since the phrases were not in the same sentence."[74] The placement of these phrases within the lease should not be dispositive of the parties' intent. Even if the same sentence contained both phrases, a better approach is to assess more generally the intent of the parties. The *Trotter* court took this approach, noting that the landowners had "never used the land for pasturage nor did they attempt to lease it to anyone for that purpose."[75] This past practice made it less likely that the parties intended to protect pasture from the lessee's reasonable use of the premises.

The aggrieved surface owner typically claims that the lessee's activities exceeded the scope of its implied easement right to explore and to develop. This claim is generally not available to neighboring surface owners, who instead might invoke basic theories of trespass, nuisance, and strict liability for damage resulting from an abnormally dangerous activity, theories that are also available to the owner of the surface above the lessee's interest.

*Williams v. Amoco Production Co.*[76] addressed whether the jury should have been instructed to consider strict liability in assessing the defendant's activities. The defendant's natural gas escaped from the defendant's wells and infiltrated the plaintiffs' irrigation wells, causing a decline in the production rate of the irrigation wells and resulting in lost crops. The defendant argued that the jury instructions should have been limited to considerations of negligence.

The primary issue in *Williams* was whether the defendant's activities of producing natural gas constituted an abnormally dan-

72. *Id.* at 681-83, 732 P.2d at 799-800 (citing Wohlford v. American Gas Prod. Co., 218 F.2d 213 (5th Cir. 1955)).

73. *Wohlford*, 218 F.2d at 215.

74. *Trotter*, 11 Kan. App. 2d at 682, 732 P.2d at 800.

75. *Id.* at 683, 732 P.2d at 800.

76. 241 Kan. 102, 734 P.2d 1113 (1987).

gerous activity, thereby subjecting the defendant to strict liability for harm resulting from the activity. The traditional test, as propounded by the classic case of *Rylands v. Fletcher*,[77] and as refined by the *Restatement (Second) of Torts*,[78] considers essentially two key factors: (1) whether the activity poses a high risk of harm, and (2) whether the defendant's activity is common and appropriate in the particular geographical area. The *Williams* court held that the theory of abnormally dangerous activity did not apply to the production of natural gas. The court concluded that the drilling and operation of gas wells in the Hugoton gas field is appropriate and common for that area and therefore not an abnormally dangerous activity.[79] The court characterized natural gas as not inherently dangerous because unlike salt water, natural gas "does not damage the fertility of the soil or growing crops; nor does it injure livestock or affect the quality of water."[80] Surely any other characterization would constitute a serious constraint on the oil and gas industry. The court's conclusion did not preclude the landowner from recovering for the lessee's negligence; the court remanded for a new trial on this issue.

The *Williams* court also considered whether nuisance principles governed the escape of gas. The court stated that nuisance occurs only if the defendant acted with the intention of interfering with the plaintiff's use and enjoyment of the plaintiff's land.[81] The court noted that the defendant initially did not intend for its gas to penetrate the plaintiffs' irrigation water and did not intend for the leak to continue once it was discovered. The *Williams* court determined that the trial court acted properly in not instructing the jury to consider nuisance.[82]

In addition to discussing theories of liability, the *Williams* court also discussed the measure of damages to be applied. The court described the measure of damages for permanent injury to land as the diminution in the fair market value of the land resulting from the defendant's activities.[83] At the trial level, the landowner's evidence assumed that all of the property was fully irrigated, whereas only part of the premises was actually irrigated. Similarly, the landowner introduced evidence that the land had no value as

77. 3 L.R.-E. & I. App. 330 (H.L. 1868).

78. RESTATEMENT (SECOND) OF TORTS § 520 (1976).

79. *Williams*, 241 Kan. at 115, 734 P.2d at 1123.

80. *Id.*; *see* Berry v. Shell Petroleum, 140 Kan. 94, 33 P.2d 953 (1934) (salt water held to be an abnormally dangerous substance).

81. *Williams*, 241 Kan. at 117-18, 734 P.2d at 1124.

82. *Id.* at 118, 734 P.2d at 1125.

83. *Id.* at 110, 734 P.2d at 1120.

irrigated land after the defendant's actions because of the presence of natural gas. Thus, the landowner attempted to maximize the preinjury value of the land and to minimize its postinjury value. But although landowners are entitled to present their land in light of its best potential use,[84] their assessment cannot assume the presence or availability of capital improvements that do not exist.[85] Accordingly, the *Williams* court held that the trial court erred in allowing damages testimony that assumed the land was fully irrigated.[86] The court also found error regarding postinjury value, citing evidence that the land contained wells that continued to be very productive.[87]

The operator's right to conduct geophysical exploration is another aspect of the relationship between operator and surface owner. The lessee's right to develop implicitly includes the right to explore by geophysical means.[88] The question remains, however, whether the lessee's exploratory rights are exclusive and not to be shared by the lessor and the lessor's agents. In *Mustang Production Co. v. Texaco, Inc.*,[89] the Tenth Circuit Court of Appeals acknowledged the lessee's implied right to conduct geophysical exploration, but held this right to be nonexclusive. The Tenth Circuit stated that "[t]he landowner retains the right to make identical uses of the land or to authorize others to do so, so long as that use does not interfere with the lessee's ability to develop the lease."[90] The scope of implied rights under a lease are those necessary for the full enjoyment of the interest conveyed. In the Tenth Circuit's view, the lessee's right to conduct geophysical exploration need not be exclusive to effectuate the purposes of the lease.[91] In addition, the Tenth Circuit did not regard geophysical exploration by others as harmful to the lessee because geophysical exploration does not cause depletion or drainage of mineral reserves and because geophysical procedures do not precisely reveal the presence or location of oil and gas.[92] The Tenth Circuit's conclusion appears to be correct. Exclusive access to geophysical information might be useful for speculative purposes, but this is not a valid

84. *Id.* (citing Steifer v. City of Kansas City, 175 Kan. 794, 799-800, 267 P.2d 474, 479 (1954)).

85. *Williams*, 241 Kan. at 110-11, 734 P.2d at 1120.

86. *Id.* at 111, 734 P.2d at 1120.

87. *Id.*

88. 1 H. WILLIAMS & C. MEYERS, *supra* note 5, § 218.5.

89. 754 F.2d 892 (10th Cir. 1985).

90. *Id.* at 894.

91. *Id.*

92. *Id.*

reason to exclude the lessor. Indeed, this consideration suggests that the lessor should be entitled to geophysical information to monitor the lessee's compliance with the implied covenant of reasonable development. In addition, the Tenth Circuit's decision provides the lessor with a reasonable opportunity to obtain information regarding the lessor's reversionary interest.[93]

The case of *Kansas Power & Light Co. v. Ritchie*[94] considered the relationship between an oil and gas lessee and the owner of a surface easement. Surface easements generally are not exclusive. An easement holder generally is entitled to use the servient estate in a limited way, without interruption or interference, but the easement holder does not necessarily have the right to exclude others from the particular tract.[95] Thus, the execution of an oil and gas lease is not necessarily incompatible with a prior conveyance of a surface easement. It is possible for the two to coexist, in which case the oil and gas lessee would have the right to use the surface for drilling and other activities so long as the lessee does not interfere with the easement holder's rights.

In *Kansas Power & Light Co.*, the Kansas Power and Light Co. ("KP&L") acquired through eminent domain proceedings a permanent easement to construct and to maintain an electric substation. The terms of KP&L's easement included the right to fence the easement and expressly stated that KP&L was entitled to the "exclusive use" of the easement. The subsequent oil and gas lessee argued that KP&L had not acquired the mineral rights, that he had the right to develop the minerals, and that his drilling activities would not interfere with KP&L's use of its easement. The court focused on the phrase "exclusive use," applied a literal meaning to the word "exclusive,"[96] and held that Ritchie should be prohibited from drilling not only the part that KP&L chose to enclose by fence, but the entire easement area.[97] The court also referred to general principles of property law, recognizing that Ritchie had

93. "[T]he lessor has at least a certain prospective interest in the mineral estate and thus perhaps may have a legitimate curiosity as to its extent even while the lease is still in effect." Phillips Petroleum Co. v. Cowden, 241 F.2d 586, 592 (5th Cir. 1957).

94. 11 Kan. App. 2d 237, 722 P.2d 1120 (1986).

95. R. CUNNINGHAM, W. STOEBUCK, & D. WHITMAN, THE LAW OF PROPERTY § 8.1 (1984) ("With an easement or profit, the right to exclude others extends only so far as to prevent their interference with the servitude's particular purpose."); RESTATEMENT OF PROPERTY § 450 comment b (1944) ("Thus, a person who has a way over land has only such control of the land as is necessary to enable him to use his way and has no such control as to enable him to exclude others from making any use of the land which does not interfere with his.").

96. *Kansas Power & Light Co.*, 11 Kan. App. 2d at 241, 722 P.2d at 1124.

97. *Id.* at 242, 722 P.2d at 1125.

rights that extended "to all purposes not incompatible" with KP&L's rights of possession and use.[98] But the court ultimately deferred to the trial court's conclusion that "Ritchie's use of the surface of the property was incompatible with KP&L's rights of possession and use and, therefore, should be prohibited by permanent injunction."[99]

*Cornwell v. Jespersen*[100] is another example of the extent to which courts are willing to protect surface owners. Damage to the plaintiffs' surface and crops was caused not by the lessee or the lessee's assignee, but by the assignee's drilling contractor. The original lease contained a clause holding the lessee responsible for loss of crops and damage to the surface. The surface owners did not rely on this clause, which might have required proof that the defendant was the assignee's agent and not an independent contractor. The surface owners also did not attempt to establish that the defendant had been negligent. Instead, the plaintiffs based their claim on the drilling contract between the lease assignee and the defendant, which contained a provision by which the defendant agreed to assume responsibility for property damage arising from drilling operations. The court said that the plaintiffs' status with regard to the drilling contract was a matter of the intent of the contracting parties:

> The contract must be made for his benefit as its object, and he must be the party intended to be benefited in order to be entitled to sue upon it. . . . Under this test a beneficiary can enforce the contract if he is one who the contracting parties intended should receive a direct benefit from the contract.[101]

Applying this test, the court held the plaintiffs to be third party beneficiaries of the drilling contract between the lease assignee and the defendant.[102] Further, the court noted that the drilling contract required the defendants to perform certain duties owed to the plaintiffs under the original lease. Therefore, the surface owners were creditor beneficiaries of the drilling contract, which entitled them to enforce it.[103] The surface owners were not entitled to punitive damages, however, as the defendants' liability was contractual only and not based on tort.[104]

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98. *Id.* (citation omitted).
99. *Id.* at 243, 722 P.2d at 1125.
100. 238 Kan. 110, 708 P.2d 515 (1985).
101. *Id.* at 115, 708 P.2d at 520 (quoting Martin v. Edwards, 219 Kan. 466, 472-73, 548 P.2d 779, 785 (1976)).
102. *Cornwell*, 238 Kan. at 117, 708 P.2d at 521.
103. *Id.* at 118, 708 P.2d at 522.
104. *Id.* at 121, 708 P.2d at 524.

In *Short v. Wise*,[105] the conflict was between a landowner and the operator of a salt water disposal well. Contrary to their agreement, the plaintiff operator allowed neighboring lessees to use the disposal well and received annual charges from some of them without forwarding the amount received to the defendant landowner. In response, the defendant instructed the neighboring operators to make future payments directly to him, rather than to the plaintiff, and barred access to the disposal wells by padlocking the gate leading to the well. This, in turn, forced the plaintiff to cease oil production to avoid overflow of salt water at the storage tank. The plaintiff claimed that the defendant's actions constituted an unlawful interference with the plaintiff's right to use the disposal well. The plaintiff also claimed that the defendant unjustly had been enriched by collecting fees for disposal of salt water by neighboring operators.

The language of the agreement was not precise; it entitled the plaintiff to dispose of salt water resulting from operations on its lease and also from operations by the plaintiff or others "in the same general area." The agreement also expressly called for additional yearly payments to the defendant for the disposal of salt water from neighboring leases. The court affirmed the trial court's finding that the plaintiff was entitled to dispose of salt water from neighboring leases because these leases were within the "same general area," but that the defendant was entitled to receive fees from the neighboring operators.[106]

The court also found that the plaintiff was entitled to damages deriving from the defendant's interference with the plaintiff's use of the disposal well.[107] As a result of the defendant's interference, the plaintiff suffered a delay in production. This does not necessarily result in damages because the operator generally suffers no loss of the mineral reserve in the absence of drainage.[108] The defendant may be liable for financial loss that occurs, however, if oil prices drop during the interference, as occurred in this case.[109] This loss of market value would be the maximum extent of the defendant's liability.[110] Finally, the court held that the plaintiff was not allowed to recover for the expense of drilling an alternative

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105. 239 Kan. 171, 718 P.2d 604 (1986).
106. *Id.* at 174, 718 P.2d at 174-75.
107. *Id.* at 175-78, 718 P.2d at 607-09.
108. *Id.* at 176, 718 P.2d at 608.
109. *Id.*
110. *Id.*

disposal well because this was a valuable improvement fully usable by the plaintiff in the future.[111]

## IV. ROYALTY INTEREST VERSUS MINERAL INTEREST

The language of a particular conveyance may be unclear regarding whether the grantor intends to convey a mineral interest or a royalty interest. For example, a conveyance of "one-eighth of all minerals produced from said land" may raise uncertainty in the characterization of the grantee's interest. The consequences of this characterization can be significant. The distinction between a royalty interest and a mineral interest can determine the quantum of production to which the interest owner is entitled.[112] It can determine whether the interest holder has the right to share in bonus payments and delay rentals.[113] It can determine whether the interest holder has the power to execute leases or to explore and to develop the premises.[114] In Kansas, it can determine whether the interest violates the rule against perpetuities.[115]

In several cases during the survey period, the courts addressed whether a particular conveyance should be classified as a royalty interest or as a mineral interest. The language of the conveyance in *Drach v. Ely*[116] offers a good example of the mix of variables that sometimes confront courts on this issue. The conveyance was of the "oil, gas and other minerals in and under and that may be produced from" a certain tract of land. Thus, the basic conveyance would seem internally inconsistent, because the words "in and under" typically refer to a mineral estate,[117] whereas some authorities have held the words "may be produced from" to refer

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111. *Id.* at 178-79, 718 P.2d at 609.

112. A 1/8 royalty interest entitles the holder to 1/8 of production, whereas a 1/8 mineral interest generally entitles the holder to only 1/64 of production (1/8 of the typical 1/8 royalty). *See generally* 1 H. WILLIAMS & C. MEYERS, *supra* note 5, § 303.1.

113. "The owner of a mineral interest is entitled to participate in lease bonus and delay rental unless the instrument provides otherwise. The owner of a royalty interest does not participate in either bonus or rental, unless a contrary provision appears in the instrument." *Id.* § 303.2.

114. The owner of a mineral interest generally enjoys this power, whereas the owner of a royalty interest generally does not. *Id.* §§ 303.3, 303.4.

115. *See* Cosgrove v. Young, 230 Kan. 705, 642 P.2d 75 (1982) (perpetual nonparticipating royalty interest held void for violation of the rule against perpetuities); Lathrop v. Eyestone, 170 Kan. 419, 227 P.2d 136 (1951) (perpetual nonparticipating royalty interest held void for violation of the rule against perpetuities); 1 H. WILLIAMS & C. MEYERS, *supra* note 5, § 303.6.

116. 237 Kan. 654, 703 P.2d 746 (1985).

117. 1 H. WILLIAMS & C. MEYERS, *supra* note 5, § 304.4.

to a royalty interest.[118] The conveyance expressly excluded any share of lease rentals, delay rentals, or bonuses payable under any lease of the particular tract. This exclusion could indicate the conveyance of a royalty interest because these rights generally are regarded as elements of a mineral interest.[119] The court noted that the conveyance did not grant the right of ingress and egress or the authority to execute oil and gas leases.[120] Despite these apparent indications of a royalty conveyance, the Kansas Supreme Court concluded that the conveyance was of undivided shares of the mineral estate.[121] The court cited prior Kansas cases holding that the phrase "in and under and that may be produced from" indicates a mineral interest.[122] The court regarded the express exclusion of rentals and bonuses as evidence of mineral interests. Otherwise, these exclusions would be superfluous because the conveyance of a royalty interest does not include these interests. Ironically, the grantor's express retention of these elements of a mineral interest helped to establish, in the court's view, that the conveyed interests were mineral interests and not royalty interests.[123] The court concluded that the conveyance was of undivided shares of the mineral estate, nonparticipating in rentals and bonuses. Consequently, the conveyance did not violate the rule against perpetuities,[124] as it would have if the court had construed it to be the conveyance of royalty interests. This result was prompted, in part, by the general view that courts should favor a construction that complies with the rule against perpetuities over one that violates the rule.[125] A more forthright approach would have been

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118. *Id.* § 304.6.

119. *Id.* § 304.10.

120. *Drach*, 237 Kan. at 656, 703 P.2d at 748.

121. *Id.* at 659, 703 P.2d at 751.

122. *Id.* at 658, 703 P.2d at 750 (citing Serena v. Rubin, 146 Kan. 603, 72 P.2d 995 (1937); Shaffer v. Kansas Farmers Union Royalty Co., 146 Kan. 84, 69 P.2d 4 (1937), *appeal dismissed*, 303 U.S. 623 (1938)).

123. The court stated:

> If the granting clause or reservation uses language which normally creates a mineral interest [as opposed to a royalty interest], . . . the rights to receive bonuses and rentals are included as normal incidents of ownership. If additional language specifically describes the right of the owner of such an interest to receive bonuses and rentals, it is surplusage. If the additional language serves to exclude the right to receive bonuses and rentals, the instrument may reasonably be construed to create a mineral interest with the specified incidents removed.

*Drach*, 237 Kan. at 659, 703 P.2d at 750 (quoting from 1 E. KUNTZ, *supra* note 41, § 16.2).

124. *Drach*, 237 Kan. at 659, 703 P.2d at 751.

125. "Where one of two permissible constructions of an instrument renders it violative

to overrule the Kansas view that perpetual nonparticipating royalty interests violate the rule against perpetuities. Kansas is alone in holding this view,[126] which is unsupported by logic or policy.[127]

The same issue arose in *Powell v. Prosser*.[128] The grantors' successors argued that the conveyance was of royalty interests that violated the rule against perpetuities. The grantee's successor argued that the conveyance was a valid and effective interest in the mineral estate. The deed conveyed "an undivided one sixteenth (1/16) interest in and to all of the oil, gas and other minerals in and under and that may be produced from" certain land. This interest was to last "forever." The grantor expressly retained the executive right, subject to the grantee's right to receive one-sixteenth of production under any lease, one-half of bonus, and one-half of rentals. The grantee also received one-half of rentals and royalty deriving from a certain lease in effect at the time of the conveyance.

The court held the grantee's interest to be an undivided share of the mineral estate.[129] The court, citing *Drach v. Ely* as authority, held that the phrase "in and under and that may be produced from" indicated a mineral interest.[130] The failure to include express rights of ingress and egress was not determinative, because these rights are implied in the conveyance of a mineral interest.[131] The grantor's retention of executive rights also was not determinative; the interest conveyed was simply a nonexecutive share of the mineral estate.[132] On all these points, the court was consistent with its decision in *Drach v. Ely*. The court, however, also cited the grantee's express right to receive one-half of bonuses and delay rentals as further indication that the grantee received a share of the mineral estate.[133] In *Drach*, the express exclusion of bonuses and delay rentals from the conveyance was a basis for concluding

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of the rule against perpetuities, and the other does not, the latter will be adopted." *Id.* at 656, 703 P.2d at 749 (citing Singer Co. v. Makad, Inc., 213 Kan. 725, 732, 518 P.2d 493, 449 (1974); Klingman v. Gilbert, 90 Kan. 545, 549, 135 P. 682, 684 (1913)).

126. 1 H. WILLIAMS & C. MEYERS, *supra* note 5, § 303.6; R. HEMINGWAY, *supra* note 3, § 2.5.

127. *See generally* Cosgrove v. Young, 230 Kan. 705, 723-25, 642 P.2d 75, 88-90 (1982) (Herd, J., dissenting); DeLaTorre, *Recent Developments in Kansas Oil and Gas Law*, 32 KAN. L. REV. 595, 604-05 (1984).

128. 12 Kan. App. 2d 626, 753 P.2d 310 (1988).

129. *Id.* at 632, 753 P.2d at 316.

130. *Id.* at 630, 753 P.2d at 314.

131. *Id.* at 632, 753 P.2d at 316 (citing 1 H. WILLIAMS & C. MEYERS, *supra* note 5, § 301).

132. *Powell*, 12 Kan. App. 2d at 631, 753 P.2d at 315.

133. *Id.*

that the grantees received a share of the mineral interest and not a royalty interest.[134] In *Powell*, the express conveyance of the same rights ironically provided a basis for the same determination that a mineral interest had been conveyed.[135] The term of the interest in *Powell* was also a factor in the court's decision. Rather than being for a term of years and then for so long thereafter as production occurred, this interest was to last "forever," which, in the court's view, indicated the conveyance of a mineral interest.[136]

Finally, although the conveyance in *Powell* was "an undivided one sixteenth interest," the court held that the grantee actually received an undivided one-half share of the mineral estate.[137] The court described the grantors' language as being based on a common misconception that because the land was under lease at the time of the conveyance, the grantors were owners of only one-eighth of the mineral estate. The conveyance of a one-sixteenth share was therefore consistent with the grantors' intent to convey one-half of their interest.[138] The court cited *Heyen v. Hartnett*,[139] which was also decided during the survey period, as authority for this analysis.

The deed in *Heyen v. Hartnett* conveyed "an undivided 1/16 interest in and to all of the oil, gas and other minerals whatsoever in and under the following described lands. . . ." Both parties agreed that the grantor conveyed an undivided share of the mineral estate, rather than a royalty interest. The grantees, however, claimed a one-half interest, despite the language of the conveyance. They argued that the parties' intent was that the grantees receive one-half of all royalties and rentals. The grantees' key argument was that the deed's reference to a one-sixteenth interest was based on a mutual mistake of the parties. The court, quoting from *Shepard,*

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134. *See supra* note 123 and accompanying text.

135. *Powell*, 12 Kan. App. 2d at 630-31, 753 P.2d at 315 (1988). Other authorities agree with this analysis:

> If the granting clause or reservation uses language which normally creates a mineral interest, the right of access and the power to lease are implied, and the rights to receive bonuses and rentals are included as normal incidents of ownership. If additional language specifically describes the right of the owner of such an interest to receive bonuses and rentals, it is surplusage. If the additional language serves to exclude the right to receive bonuses and rentals, the instrument may reasonably be construed to create a mineral interest with the specified incidents removed.

1 E. KUNTZ, *supra* note 41, § 16.2, at 486-87.

136. *Powell*, 12 Kan. App. 2d at 632, 753 P.2d at 315.

137. *Id.* at 633, 753 P.2d at 316.

138. *Id.* at 632, 753 P.2d at 315.

139. 235 Kan. 117, 679 P.2d 1152 (1984).

*Executrix v. John Hancock Mutual Life Insurance Co.*,[140] explained the basis for the confusion:

> [T]he confusion of fractional interests stems primarily from the mistaken premise that all the lessor-landowner owns is a one-eighth royalty. In conveying minerals subject to an existing lease and also assigning a corresponding fractional interest in the royalties received, mistake is often made in the fraction of the minerals conveyed by multiplying the intended fraction by one-eighth. Thus, if a conveyance of an undivided one-half of the minerals is intended, the parties will multiply one-half by one-eighth and the instrument will erroneously specify a conveyance of one-sixteenth of the minerals upon the assumption that one-sixteenth is one-half of what the grantor owns.[141]

The court agreed with the grantees and held that they were entitled to receive one-half of the royalties.[142] The grantor's successor argued that the grantees were generally entitled to only one sixteenth of the royalties and that the grantees' one-half interest in royalties and rentals applied only to leases in effect as of the date of the conveyance to the grantees. The grantor's successor pointed to the language in the conveyance that entitled the grantees to one-half of royalties "[i]f such land is covered by a valid oil and gas or other mineral lease. . . ." The court rejected this argument. The court noted that the parties surely must have known that no lease existed at the time of the conveyance and therefore did not intend for the one-half interest in royalties to be so limited. In the court's view, the parties intended that the language apply whenever the land became covered by a lease,[143] although this interpretation would render the language superfluous because royalties normally arise only if a lease is in effect.

## V. ABANDONMENT AND IMPLIED COVENANTS

Lack of activity by the lessee may indicate abandonment of lease rights, or it might constitute a breach of the implied covenant of reasonable development. In either case, the lessor suffers economically and may seek a judicial termination of the lease to engage a new lessee who will be productive. An issue that arises in this situation is whether the lessor must make a demand upon the current lessee for the termination to be effective.

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140. 189 Kan. 125, 368 P.2d 19 (1962).

141. *Heyen*, 235 Kan. at 125, 679 P.2d at 1158 (quoting from *Shepard, Executrix*, 189 Kan. at 134-35, 368 P.2d at 26-27).

142. *Heyen*, 235 Kan. at 125, 679 P.2d at 1159.

143. *Id.* at 123-24, 679 P.2d at 1157.

This was a major issue in *Rook v. James E. Russell Petroleum, Inc.*,[144] in which the lease allowed for production and storage and was to be effective while oil or gas was produced "or the storage right is being exercised." The evidence strongly indicated that the lessee had no intention of resuming drilling activity in the near future.[145] Neither the lessee nor the assignee engaged in production or exploration on the leased premises for fifteen years. The lessee's assignee believed that the entire lease was sustained by the exercise of storage rights and the payment of gas storage rentals. The Kansas Court of Appeals held that the lessor's claim of abandonment was based on an alleged breach of an implied covenant and that demand of performance was therefore a prerequisite to cancellation of the lease.[146] The court of appeals apparently believed that abandonment could only be based on the breach of an implied covenant. The Kansas Supreme Court, however, had no difficulty in viewing this case as one of abandonment, independent from the effect of implied covenants. The court held that the lessee's assignee effectively abandoned its production rights under the lease, even though the lessor had not provided notice and demand.[147] This decision is in accord with the general view that notice and demand are not essential to a finding of abandonment.[148] The court held, however, that only the development rights had been abandoned and not the storage rights.[149] Therefore, the requirements of the habendum clause of the lease were technically met[150] despite the cessation of production, but part of the lease rights had been abandoned. This conclusion seems reasonable and appropriate. Courts occasionally award partial cancellation of leases on a ge-

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144. 235 Kan. 6, 679 P.2d 158 (1984).

145. According to the court:

> Russell ceased production of [certain wells on the premises] in 1966, and since that time no oil or gas has been produced and no new wells have been drilled by either Russell or the appellant corporation of which Russell is president. . . .
>
> Equipment left on the property was allowed to rust and deteriorate. In the early 1970's the pump house was torn down and removed after it was partially demolished in a storm. The power source equipment was also removed at that time because it was obsolete and could no longer be used with any available methods of recovery. The defendant was not physically present on the land after 1972.

*Id.* at 10, 679 P.2d at 161-62.

146. Rook v. James E. Russell Petroleum, Inc., 8 Kan. App. 2d 412, 658 P.2d 1059 (1983), *rev'd*, 235 Kan. 6, 679 P.2d 158 (1984).

147. *Rook*, 235 Kan. at 19, 679 P.2d at 167.

148. 4 H. WILLIAMS & C. MEYERS, *supra* note 5, § 682.3.

149. *Rook*, 235 Kan. at 18, 679 P.2d at 166-67.

150. *Id.* at 17, 679 P.2d at 166.

ographical basis.[151] If a court has the power to sever a lease on that basis, a court also should be able to sever on the basis of distinctive rights.[152]

The Kansas federal district court also discussed the requirement of demand during the survey period. In *Amoco Production Co. v. Douglas Energy Co.*,[153] the federal district court confirmed that demand is a prerequisite to forfeiture for breach of the implied covenants.[154] The court also referred to the *Rook* case and its holding that "termination, without demand and notice, is appropriate under facts supporting a finding of true abandonment."[155] The district court in *Amoco Production* determined that the lessee showed no intent to abandon its rights and that the lessee's slow pace[156] constituted only a possible breach of the implied covenant of exploration and development. Despite the lessors' failure to make a demand, the district court concluded that summary judgment for the lessee was inappropriate. The court found that the lessors stated a sufficient claim, because even though unconditional forfeiture was unavailable for lack of demand, the district court could have awarded a conditional forfeiture, one that is subject to a grace period within which the lessee must comply with the implied covenant of reasonable development.[157] The district court also could have awarded monetary damages.[158] In addition, the lessors might have been able to establish that a demand would have been futile, which would eliminate the need for demand.[159] This possibility raised an issue of fact. For all these reasons, the federal district court determined that the lessors stated a sufficient claim, and summary judgment was therefore inappropriate.

The court in *Amoco Production* also discussed the Kansas Deep Rights Act.[160] Enacted in 1983, this statute codifies, with some modification, the implied covenants to explore and to develop.[161] The statute creates a presumption that the covenants have been

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151. *Id.* at 17-18, 679 P.2d at 166.

152. The evidence indicated that the parties considered the storage rights and the productive rights to be separate and distinct. *Id.* at 13, 679 P.2d at 164.

153. 613 F. Supp. 730 (D. Kan. 1985).

154. *Id.* at 733.

155. *Id.* at 734.

156. Douglas Energy alleged that Amoco's activities were limited to the drilling of shallow gas wells and that oil and gas reserves in deeper formations remained undeveloped. *Id.* at 732.

157. *Id.* at 736.

158. *Id.* at 735 (citing Alford v. Dennis, 102 Kan. 403, 170 P. 1005 (1918)).

159. *Amoco Production*, 613 F. Supp. at 736.

160. KAN. STAT. ANN. §§ 55-223 to -229 (1983).

161. *See* DeLaTorre, *supra* note 127, at 622-23.

breached when no minerals have been produced from a particular formation for fifteen years following the commencement of mineral production on the leased premises.[162] The statute shifts the burden of proof to the lessee to establish compliance with the implied covenants.[163] The statute does not eliminate the standard of the reasonably prudent operator,[164] nor does it eliminate demand as a prerequisite to forfeiture.[165] The federal district court in *Amoco Production* held that the statute applied to the case even though the litigation was pending when the statute was enacted. The court referred to the Kansas rule that permits newly enacted statutes to be applied in pending litigation if the new statute affects only procedural matters and not substantive rights.[166] The court determined that the only significant change resulting from the statute was the shifting of the burden of proof on the question of compliance with the implied covenants to explore and to develop.[167] Because matters regarding the burden of proof are procedural and not substantive,[168] the court concluded that it was proper to apply the statute to this case.

## VI. ISSUES PERTAINING TO POOLING AND UNITIZATION

The survey period includes a series of cases that demonstrate the various effects of pooling and unitization.[169] One of the consequences of pooling is that production anywhere on the unit is sufficient to sustain all component leases beyond their primary terms.[170] The cases of the survey period illustrate this effect and the extent to which it applies to term mineral interests. The courts also addressed certain aspects of unit dissolution.

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162. KAN. STAT. ANN. § 55-224 (1983).

163. *Id.* § 55-225.

164. *Amoco Production*, 613 F. Supp. at 737; KAN. STAT. ANN. § 55-229 (1983) ("This act shall not alter or affect substantive rights or remedies under any such mineral leases under the common law or statutes of the state of Kansas.").

165. *Amoco Production*, 613 F. Supp. at 737; KAN. STAT. ANN. § 55-229 (1983).

166. *Amoco Production*, 613 F. Supp. at 737.

167. *Id.* at 736.

168. *Id.* at 737.

169. One commentator distinguishes "pooling" from "unitization" as follows:

> Although the terms "pooling" and "unitization" are frequently used interchangeably, more properly "pooling" means the bringing together of small tracts sufficient for the granting of a well permit under applicable spacing rules whereas "unitization", or, as it is sometimes described, "unit operation," means the joint operation of all or some part of a producing reservoir.

6 H. WILLIAMS & C. MEYERS, *supra* note 5, § 901 (footnote omitted).

170. *See* Morgan v. Mobil Oil Corp., 726 F.2d 1474, 1477 (10th Cir. 1984).

*Edmonston v. Home Stake Oil & Gas Corp.*[171] involved a compulsory unit that included part, but not all, of a particular tract. Production occurred on the unit but not on any part of the particular tract. The issue was whether this production was sufficient to extend a defeasible term mineral interest in the particular tract beyond its primary term. The reversioner apparently conceded that the on-unit portion of the mineral interest was sustained beyond the primary term.[172] The specific issue therefore was whether the unit production sustained the off-unit part of the term mineral interest. The Kansas Supreme Court held that although the unit production sustained the on-unit part of the term mineral interest, it did not sustain the off-unit part.[173] The court noted that this result is consistent with prior Kansas cases involving voluntary pooling. According to these prior Kansas cases, the off-unit part will be sustained only by its own independent production.[174] The court recognized this as the Kansas view generally and then asserted that the Kansas compulsory unitization statute does nothing to compel a different conclusion.[175] Indeed, the statute seems only to extend the established rule by stating that "[p]roperty rights . . . shall be regarded as amended and modified only to the extent necessary to conform to the provisions and requirements of this act. . . ."[176] The court supported its decision with the questionable rationale that the term interest owners were "free to pursue development and production" from the off-unit part.[177] Although this may be accurate for lessees, it is not accurate for a term mineral interest owner who has conveyed the development rights to a lessee.

Justice Herd strongly dissented from the majority opinion. His straightforward position was that production that occurs on the unit constitutes production on the on-unit part of the term mineral interest, and that production on any part of the term mineral interest perpetuates the entire interest.[178] Essentially, his view assumes the indivisibility of term mineral interests that have been pooled or unitized. Justice Herd seemed to call for overruling the

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171. 243 Kan. 376, 762 P.2d 176, *aff'd mem.*, 854 F.2d 1323 (10th Cir. 1988).

172. *See* Classen v. Federal Land Bank, 228 Kan. 426, 617 P.2d 1255 (1980).

173. *Edmonston*, 243 Kan. at 383, 762 P.2d at 181.

174. *Classen*, 228 Kan. at 426, 617 P.2d at 1255; Friesen v. Federal Land Bank, 227 Kan. 522, 608 P.2d 915 (1980).

175. *Edmonston*, 243 Kan. at 382, 762 P.2d at 180.

176. KAN. STAT. ANN. § 55-1308 (1983) (discussed in *Edmonston*, 243 Kan. at 381, 762 P.2d at 179-80).

177. *Edmonston*, 243 Kan. at 382, 762 P.2d at 180.

178. *Id.* at 383-84, 762 P.2d at 182-83.

established Kansas position, terming that position a "mistake."[179]

The Kansas courts take a different view regarding leases. When leased premises are partially pooled, the Kansas position is that they are indivisible. The entire lease, including that part of the lease lying outside the unit, will be sustained by production on the unit, even if the production does not take place on any part of the leased premises.[180] To assure divisibility when partial pooling occurs, the lessor must be sure that the lease includes a Pugh clause, which essentially states that production on a pooled unit will maintain the lease only as it relates to land included within the unit.

*Mesa Petroleum v. Schieb*[181] addressed whether certain lease language produced the same effect as a Pugh clause. The lessor argued that a severance occurred and that the off-unit part of the lease was not sustained by the unit production, even though the production occurred on the lease itself. The lessor asserted that this result was compelled by language in the pooling clause stating that exercise of the pooling power "shall not affect the payment or non-payment of delay rentals with regard to portions of this premises not included in a unit." The Tenth Circuit Court of Appeals, applying Kansas law, rejected this argument and held that this language was not sufficiently explicit to effect a severance upon production from the unit.[182] In the Tenth Circuit's view, the language did not express any intent or purpose regarding this issue. In addition, the lessor accepted shut-in royalties from the lessee in an amount that covered the entire acreage of the lease. The court regarded this as strong evidence that the parties did not

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179. *Id.* at 384, 762 P.2d at 183.

180. Somers v. Harris Trust & Savings Bank, 1 Kan. App. 2d 397, 566 P.2d 775 (1977). According to the court of appeals:

> The rationale of [this] rule is recognition by the courts that the implied covenants for reasonable development and protection against drainage apply to leased lands outside of pooled units . . . . These covenants are deemed by the courts to be sufficient remedies to compel lessees to protect the lessors' other lands from drainage and to proceed with their reasonable development in due course. We add that these covenants exist independent of the primary term and continue to protect the outside acreage. The covenant to develop requires the lessee to develop all of the lease as would any ordinary prudent operator. These [lessors] have a remedy for a breach of this covenant if it occurs, which remedy could consist of either a cancellation of that part of the lease, for damages, or for both.

*Id.* at 402-03, 566 P.2d at 799 (quoting Clovis v. Pacific Corp., 140 Colo. 552, 556, 345 P.2d 729, 731 (1959)). Similar protection is not available, however, to the owner of the reversionary interest following a term mineral interest.

181. 726 F.2d 614 (10th Cir. 1984).

182. *Id.* at 616.

intend that the lease be severed when only part of the leased premises was pooled.[183] Thus, not only was there no express language effecting a severance, but the conduct of the parties affirmatively indicated the intent not to sever.

*Morgan v. Mobil Oil Corp.*[184] involved the vertical scope of a unitization agreement. This case was a consolidation of two cases, *Morgan* and *Anadarko Production Co. v. Taylor.*[185] Both cases addressed whether a particular unitization agreement was limited to certain geological formations. A unit operating agreement was formed because of a Kansas Corporation Commission unitization order for the Hugoton formation. The agreement was later amended for matters relating to production from the Panoma-Council Grove formation. In *Morgan*, one of the lessees subsequently drilled from a formation deeper than the Panoma-Council Grove formation. The lessors asserted that the particular lease was extended beyond the primary term only by virtue of the unitization agreement and therefore was no longer effective for any geological formation deeper than the Panoma-Council Grove formation. The lessees responded that the agreement was not limited to particular formations and that absent a specific limitation, the agreement should extend to all formations underlying the leased premises. These arguments raised the issue of whether the unitization agreement was limited to particular geological formations.

The Kansas Supreme Court agreed with the lessees, finding that nothing in the original unitization agreement or in the amendment indicated any intent by the parties to limit the scope of the agreement to either the Hugoton or the Panoma-Council Grove formation. To the contrary, the agreement and amendment contained language that was general and unlimited. The court focused on the broad language of the original agreement:

> The production of oil and/or gas from said unitized area in paying quantities, shall perpetuate the oil and gas rights of Lessee under all of said leases in said entire unitized area and relieve Lessee from all further obligations to drill and/or to pay delay rentals under any and all leases covering lands within said area . . . .[186]

The original agreement contained no language that applied exclusively to any particular formation. The amendment specifically referred to the Panoma-Council Grove formation, but did not

183. *Id.* at 616-17.

184. 726 F.2d 1474 (10th Cir. 1984).

185. 535 F. Supp. 103 (D. Kan. 1982), *rev'd and aff'd in part*, Morgan v. Mobil Oil Corp., 726 F.2d 1474 (10th Cir. 1984).

186. *Morgan*, 726 F.2d at 1478.

limit the unitization to that formation. The court concluded that the intent of the parties was to unitize the tracts entirely "without limitations as to horizons."[187] As a result, the lessee was entitled to drill at levels deeper than the Panoma-Council Grove formation.

In the *Anadarko* case, the issue was whether the unitization agreement applied to formations deeper than the Hugoton formation, and particularly whether it applied to the Panoma-Council Grove formation. The resolution of this issue would determine whether lessors of neighboring tracts were entitled to share in royalties from production from the Panoma-Council Grove formation. As in *Morgan*, the Kansas Supreme Court found no language showing that the parties intended to limit the agreement to the Hugoton formation. In fact, the agreement did not mention the Hugoton formation. The court held that because the agreement was unambiguous, the trial court should not have considered extrinsic evidence on the parties' intent.[188] The original Kansas Corporation Commission order, which was limited to the Hugoton Field, was only the inducement for the unitization agreement and should not have been used as a limit on the parties' intent.[189] The court concluded that the unitization agreement applied to all formations, not just to the Hugoton formation.[190] These cases illustrate an apparent presumption that a pooling or unitization agreement applies to all formations unless expressly stated otherwise. In both *Morgan* and *Anadarko*, the court found no evidence to counteract that presumption.

The lessee's authority to pool or to unitize typically is accompanied by a lease provision that reduces the lessee's royalty obligation when production occurs on the lessor's land. The lessor's royalty usually is reduced to reflect the proportion that the lessor's acreage bears to the unit. In *Veverka v. Davies & Co.*[191] the lease called for the standard one-eighth royalty, and typewritten language appearing at the bottom of the form lease entitled the lessor to an additional one-sixteenth royalty. The lease expressly authorized the lessee to pool, and it also reduced the lessor's royalty proportionately in the event that unit production occurred on the leased premises. The issue was whether this reduction applied not only to the standard one-eighth royalty, but also to the one-sixteenth

187. *Id.*

188. *Id.* at 1480. Thus, the trial court improperly considered evidence showing the "obvious inter-relationship" between the unitization agreement and the Kansas Corporation Commission's Hugoton Proration Order. *Id.*

189. *Id.* at 1480-81.

190. *Id.* at 1480.

191. 10 Kan. App. 2d 578, 579, 705 P.2d 558, 560 (1985).

interest created by the typewritten language. The court held that the one-sixteenth interest was not different in nature from the standard one-eighth interest in any significant way and was therefore not exempt from the proportionate reduction.[192]

Two cases from the survey period address whether a valid unitization was in effect. In *Rosenbaum v. Texas Energies, Inc.*,[193] the Kansas Supreme Court held that the attempted unitization had never been effective. The lessor and lessee's agent agreed to include language in the lease setting a 240-acre limit on the size of unit that could be formed by the lessee. Both parties thought that this limitation effectively would preclude unitization. When the lessee later purported to unitize, the lessor objected and refused to sign a division order. After the lessor expressed her belief that the lease terms precluded unitization, the lessee recorded certain instruments to terminate the unit. The neighboring tract owners then brought suit to prevent the lessee from deunitizing. The court sided with the lessee, stating that extrinsic evidence is admissible to show a mutual mistake.[194] Even though parties generally are responsible to know and to understand the contents of their written agreements, they are not bound by provisions that result from mutual mistake,[195] even if the mistake is one of law rather than fact.[196] The court therefore held that the attempt to pool was not effective and that no valid unit had been created.[197]

*Parkin v. State Corporation Commission*[198] involved the validity of the Kansas Corporation Commission's denial of an application for dissolution of a particular unit. The unit had been established for conducting secondary recovery operations. The Commission's unitization order was to be effective "for so long as unitized substances are produced in paying quantities, and as long thereafter as unit operations are conducted."[199] Thirteen years later, the mineral interest owners and royalty interest owners applied to the Commission to dissolve the unit. By that time the operator had ceased water injection and no repressuring had occurred. The operator also had reduced the number of producing wells from twenty-five to six, removed much of its equipment from the unit,

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192. *Id.* at 583, 705 P.2d at 562.
193. 241 Kan. 295, 736 P.2d 888 (1987).
194. *Id.* at 298, 736 P.2d at 891.
195. *Id.* at 299, 736 P.2d at 892.
196. *Id.* at 302, 736 P.2d at 893.
197. *Id.*
198. 234 Kan. 994, 677 P.2d 991 (1984).
199. *Id.* at 998, 677 P.2d at 995 (quoting the Kansas Corporation Commission's May 24, 1968, order).

and drilled only three new wells (all of which were unsuccessful) during its years of production. Production had dropped from sixty-five barrels per day to twenty-four barrels per day.[200] The Commission denied the application for dissolution, primarily on the ground that the working interest owners continued to believe that the unit could be developed in paying quantities. In the Commission's view, the unitization agreement authorized the working interest owners to make this determination.[201] The trial court affirmed, primarily for the same reason.[202]

The Kansas Supreme Court reversed. The court first rejected the claim of the mineral and royalty interest owners that the cessation of secondary recovery operations was sufficient ground for dissolving the unit. The court referred to the applicable statute and noted that a sufficient basis for compulsory unitization was the need for "the unitized management, operation and further development of the pool."[203] The court concluded that the cessation of waterflooding alone was not sufficient ground to dissolve the unit.[204]

The court, however, held that the Commission erred in ruling that the unit would continue until the owner of the working interest determined that the unitization should terminate. The Commission's ruling was in accord with the unitization agreement, which expressly gave the working interest owner the power to make this determination. The court held that the unitization agreement was not binding on all royalty or mineral interest owners, however, because not all owners had expressly agreed to it.[205] The Commission forced unitization upon the owners in accordance with the Commission's statutory authority and therefore the unitization was not a matter of volitional contractual agreement. The parties were bound by the unitization order, but not by the unitization agreement, which was a private agreement limited to parties who actually agreed to it. The unitization order stated that operations would continue "for as long as unit operations are conducted." The court defined the term "unit operations" to include "not only the process of unitizing the area, centralizing management, pumping a few wells, and dividing royalty proceeds . . . [but] also . . . the

200. *Id.* at 999-1000, 677 P.2d at 996.

201. *Id.* at 1001, 677 P.2d at 996-97 (quoting the Kansas Corporation Commission's June 3, 1982, order).

202. *Id.* at 1001-03, 677 P.2d at 997-98 (citing the district court's findings of fact and conclusions of law).

203. *Id.* at 1004, 677 P.2d at 999-1000 (quoting KAN. STAT. ANN. § 55-1304).

204. *Parkin*, 234 Kan. at 1006, 677 P.2d at 1001.

205. *Id.* at 1007, 677 P.2d at 1001-02.

good faith operations and prudent development of the unit."[206] Thus, not only did the court impose on the operator the implied covenant of reasonable development, it also interpreted the term "unit operations" to include compliance with the implied covenant and thereby made continuation of the unit dependent on compliance. The court further held that the issue of compliance must be decided by the Kansas Corporation Commission and not left to the unilateral judgment of the operator.[207] To allow the operator to make this determination constituted an improper delegation of the Commission's statutory responsibility.

The *Parkin* court based much of its discussion on the particular order of unitization, the order's inclusion of the term "unit operations," and the court's own determination that "unit operations" required compliance with the covenant of reasonable development. The court's ultimate holding, however, seems not to be confined to the particular language chosen by the Commission. The court's holding was that "the implied covenant to develop, measured by the reasonably prudent operator test, applicable to lessees of individual leases, is equally applicable to the operators of unitized leases."[208] The essence of *Parkin*, therefore, seems to be that apart from the specific language of a particular unitization order, the unit operator's activities are governed by the implied duty of reasonable development and that failure to comply with this duty is potential ground for dissolution.

## VII. THE EFFECT OF MORTGAGES ON THE RIGHT TO DEVELOP

The Kansas Supreme Court encountered the issue of mortgagors' rights in *Home State Bank v. Johnson*.[209] The mortgagor generally retains title to and possession of the mortgaged property, subject to the security interest of the mortgagee.[210] This situation raises the question of whether the mortgagor also retains the right to produce oil and gas. Some jurisdictions have held that production of oil and gas constitutes waste because it results in depletion of the land and therefore can be enjoined by the mortgagee.[211] In *Home State Bank*, however, the Kansas court held that the production of oil and gas is not waste.[212] The court recognized that

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206. *Id.* at 1008, 677 P.2d at 1002-03.

207. *Id.* at 1010-11, 677 P.2d at 1004.

208. *Id.* at 1009, 677 P.2d at 1003.

209. 240 Kan. 417, 729 P.2d 1225 (1986).

210. *See* Misco Indus., Inc. v. Board of County Comm'rs, 235 Kan. 958, 962, 685 P.2d 866, 870-71 (1984).

211. 2 H. WILLIAMS & C. MEYERS, *supra* note 5, § 518.

212. *Home State Bank*, 240 Kan. at 429, 729 P.2d at 1234.

production causes depletion, but said that mineral production is no different in this regard from grazing cattle or raising crops, activities that also cause depletion but are normally permitted.[213] The mortgagor is therefore generally entitled to produce oil and gas,[214] and is entitled to continue this production through the redemption period following foreclosure. The royalties deriving from this production constitute rents and profits to which the mortgagor is statutorily entitled.[215] This right is not negated by section 60-2414 (a) of Kansas Statutes Annotated, which states that the mortgagor's right of redemption "shall not apply to oil and gas leaseholds." This language refers only to the lessee's interest, not to the lessor's royalty interest.[216] Although the mortgagor was entitled to royalties generated during the redemption period, the court in *Home State Bank* further held that the royalties should first be applied to an earlier unforeclosed mortgage because of an express assignment of those royalties to the prior mortgagee. Once the prior mortgagee was fully paid, the mortgagors would again be entitled to royalties generated during the remainder of the redemption period.[217]

## VIII. MECHANICS' AND SUBCONTRACTORS' LIENS

Three cases from the survey period[218] dealt with the complications of mechanics' liens. In *Calvert Western Exploration Co. v. Dia-*

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213. *Id.*

214. The court did not indicate whether this right is limited to leases executed prior to the execution of the mortgage. Professor David E. Pierce notes that the right generally is not limited to such leases absent express lease provisions indicating otherwise:

> The owner of mortgaged land may not, in some cases, be able to grant a valid oil and gas lease covering land subject to the mortgage. The express terms of the mortgage agreement must be reviewed to determine the mortgagor's ability to lease the affected land. If the mortgage agreement does not expressly address the matter, in Kansas a mortgagor can permit mining of the property to the extent it does not impair the mortgagee's security. Since most mortgages are made based upon something less than 100% of the value of surface improvements, the removal of oil and gas should seldom impair the mortgagee's security.

D. PIERCE, *supra* note 45, § 11.11 (citing *Misco Indus., Inc.*, 235 Kan. at 958, 685 P.2d at 866; Vanderslice v. Knapp, 20 Kan. 647 (1878)).

215. *Home State Bank*, 240 Kan. at 429, 729 P.2d at 1234; *see* KAN. STAT. ANN. § 60-2414(a) (1983).

216. *Home State Bank*, 240 Kan. at 427, 729 P.2d at 1232.

217. *Id.* at 429-30, 729 P.2d at 1234.

218. Calvert Western Exploration Co. v. Diamond Shamrock, 234 Kan. 699, 675 P.2d 871 (1984); Consolidated Oil Wells Servs., Inc. v. State Oil Co., 12 Kan. App. 2d 422, 747 P.2d 183 (1987); DaMac Drilling, Inc. v. Shoemake, 11 Kan. App. 2d 38, 713 P.2d 480 (1986).

*mond Shamrock*,[219] Calvert Western sought to enforce a subcontractor's lien based on its performance of drilling services. The lessee Diamond Shamrock engaged Love Enterprises to drill a well on the premises. Love Enterprises, prior to this time, had contracted with Calvert Western to provide a drilling rig and crews. When Calvert Western later submitted a bill to Love Enterprises for the services rendered, Love Enterprises refused to pay. Calvert Western, claiming to be an oil and gas subcontractor to the contract between Diamond Shamrock and Love Enterprises, then filed suit to foreclose its oil and gas liens on Diamond Shamrock's leases. The Kansas Supreme Court first determined that the agreement between Love Enterprises and Calvert Western was a drilling contract and not a mere lease of personal property. Love received more than the right to use a rig for a specified period of time. The actual operation of the rig was performed by crews provided by Calvert Western. Calvert Western was obligated to furnish Love with daily reports of its activities and was responsible for supplying various items of equipment. The court therefore concluded that the agreement between Calvert Western and Love was not merely a lease of a drilling rig, but rather was "a comprehensive package deal under which Calvert Western also provided personnel, equipment and services."[220] Because the arrangement was a drilling contract and not a lease, it provided the potential basis for a subcontractor's lien.[221]

The court ultimately concluded, however, that Calvert Western was not entitled to a subcontractor's lien. The court referred to the general definition of subcontractor "as one who has entered into a contract, express or implied, for the performance of an act with a person who has already contracted for its performance."[222] The court also referred to Kansas authority that described a subcontractor as "one who assumed a portion of a contract from an original contractor for the performance of all or part of the services or work which the other had obligated itself to perform under the contract with the owner."[223]

The court therefore concluded that Calvert Western was not entitled to a subcontractor's lien, because its agreement with Love Enterprises predated the prime contract between Love Enterprises and Diamond Shamrock.[224] This conclusion is consistent with the

219. 234 Kan. 699, 675 P.2d 871 (1984).
220. *Id.* at 703-04, 675 P.2d at 875.
221. *Id.* at 704, 675 P.2d at 875.
222. *Id.* (citations omitted).
223. *Id.* (citations omitted).
224. *Id.* at 705, 675 P.2d at 875 (citations omitted).

general rule,[225] although the narrow focus on the timing of the two transactions in this particular case ignores the obvious relationship between the two transactions.

The court in *Calvert Western Exploration* also held that Speedy Oilfield Services, who had performed a contract to transport Calvert Western's rig onto the premises, was not entitled to a subcontractor's lien against the lease.[226] Speedy did not meet the requirement of the general oil and gas lien statute. That statute applied only to the provision of labor or materials used in the "digging, drilling, torpedoing, completing, operating or repairing" of an oil or gas well, and the court held that the hauling and transporting of oil field equipment did not constitute "digging, drilling, torpedoing, completing, operating or repairing."[227] Mechanics' liens for transporting and hauling oil field equipment are governed by section 55-213 of Kansas Statutes Annotated. That statute limits such liens to equipment and material possessed by the party with whom the hauler has contracted.[228] Thus, that statute did not entitle Speedy Oil to a lien on Diamond Shamrock's lease.

In *DaMac Drilling, Inc. v. Shoemake*,[229] the lessee DaMac challenged liens claimed by Rex Hawkins and Geological Services, Inc. on technical grounds. DaMac claimed that Geological Services failed to itemize the services it rendered and that Hawkins failed to provide proper verification of alleged facts to support his claim. The Kansas Court of Appeals held that Hawkins' attempted verification was inadequate because it failed to state that he had personal knowledge of the recited information. Hawkins' verification stated only that the information was "true and correct to the best of his knowledge, information and belief."[230] On the issue of itemization, DaMac argued that Geological Services' itemization failed to list the geological services rendered, as required by section 55-209 of Kansas Statutes Annotated. The lien statement included certain information from an invoice, but this information did not specify the actual services rendered by Geological Services.[231] Ge-

225. *See id.* at 704, 675 P.2d at 875 (citing 57 C.J.S. *Mechanics' Liens* § 98 (1948); 53 AM. JUR. 2D *Mechanics' Liens* § 68 (1970); Rogers v. Crane Co., 180 Okla. 139, 142, 68 P.2d 520, 524 (1937)).

226. *Calvert Western Exploration*, 234 Kan. at 706, 675 P.2d at 876.

227. *Id.* at 706-07, 675 P.2d at 876.

228. *Id.*

229. 11 Kan. App. 2d 38, 713 P.2d 480 (1986).

230. *Id.* at 42, 713 P.2d at 484. The court relied on Lewis v. Wanamaker Baptist Church, 10 Kan. App. 2d 99, 692 P.2d 397 (1984), which held similarly in a case involving a general mechanics' lien under KAN. STAT. ANN. § 60-1102.

231. The invoice referred only to dates on which services were rendered and the amount charged for such services. *DaMac Drilling, Inc.*, 11 Kan. App. 2d at 43, 713 P.2d at 484.

ological Services argued that a more specific itemization was not required because DaMac had bargained for the services rendered. The court agreed.[232] The purpose of itemization is to allow the leasehold owner to check the accuracy of the claim. The court held that this purpose is met by an invoice that reflects a prior agreement by the parties on the work to be performed and the fee to be paid; this is particularly so when the job has been completed before the lien statement is filed.[233] The court concluded that the invoice met the requirements of itemization.

More substantively, DaMac argued that a lien was inappropriate because the services rendered by Geological Services did not constitute "labor" as defined by section 55-207 of Kansas Statutes Annotated. Geological Services conducted on-site examinations and analyses of well cuttings, prepared daily logs, and supervised testing procedures. DaMac argued that these were professional services not covered by section 55-207, which DaMac argued covers only physical labor. Geological Services countered that its services directly assisted actual drilling work and should therefore be covered by the statute.

The court agreed with Geological Services. The court termed this issue one of first impression[234] and distinguished the *Calvert Western Exploration* case on the basis that the activities of an on-site geologist directly related to the construction and operation of an oil and gas well, whereas mere transportation of equipment did not.[235] The court propounded a general test for the application of section 55-207: "the protected labor should be the type of work which improves the property in a manner which would be apparent to third-party purchasers so that they would be put on notice that lienable claims may be outstanding."[236] All of Geological Services' work was done with the use of equipment on the land and was an "integral part of efficient oil and gas exploration and development."[237] Unlike preliminary feasibility studies conducted off site, the work done by Geological Services would have been apparent to any reasonably prudent observer. The court also considered the aspect of unjust enrichment, labeling it the "fundamental principle underlying the provision of mechanics' liens."[238] The court concluded that the geologist provides the lessee with

232. *Id.* at 43-44, 713 P.2d at 484-85.
233. *Id.* (citing Lumber Co. v. McCurley, 84 Kan. 751, 115 P. 590 (1911)).
234. *DaMac Drilling, Inc.*, 11 Kan. App. 2d at 45, 713 P.2d at 485.
235. *Id.* at 45, 713 P.2d at 486.
236. *Id.* at 45-46, 713 P.2d at 486.
237. *Id.* at 46, 713 P.2d at 486.
238. *Id.*

benefits as valuable as the products of physical labor, particularly in minimizing development costs by helping to avoid the expense of drilling at unpromising locations. The court said that work is covered by section 55-207 if it results in the "on-site advancement of the construction, repair or operation of an oil or gas well such that the leasehold owner would be unjustly enriched if not burdened by a lien," even if the work involves mental effort and not manual toil.[239] The court concluded that Geological Services' activities were covered by section 55-207.[240]

The court also discussed whether a lien claimant is entitled to foreclose on an overriding royalty interest that pre-existed the claimant's interest. DaMac referred to the language of section 55-207 providing that the lien attaches to the "whole of such leasehold" and argued that the lien should therefore apply to the overriding royalty interest, even though it was created and recorded prior to DaMac's interest. The owners of the overriding royalty interest based their position on time priority, arguing that by the time that Geological Services did its work, the overriding royalty interest was no longer part of the lessee's interest and therefore could not be charged with a lien claim.

The court ultimately agreed that the overriding royalty interest was not subject to the lien, but for reasons different from those offered by the interest owners. The court's premise was that the holder of an overriding royalty interest has no claim in the leasehold itself, but only a right to receive part of the production. Because the lien is a charge on the leasehold, the overriding royalty interest is therefore not subject to the lien.[241] Finally, the court noted that foreclosure against the lease simply compels a sale of the lease, not its termination. Thus, the overriding royalty interest, which depends for its existence on the continuation of the lease, is not extinguished by the foreclosure.[242]

In *Consolidated Oil Wells Services, Inc. v. State Oil Co.*,[243] the Kansas Court of Appeals addressed whether a mechanics' lien filed under section 55-207 had priority over a lien created in oil and gas lessors by express provisions of their lease. The lease entitled the lessors to a lien "to satisfy any loss or damage suffered by lessors because of the failure of the lessees to carry out the terms and conditions of this lease."[244] The lease obligated the lessees to

239. *Id.*
240. *Id.*
241. *Id.* at 49, 713 P.2d at 488.
242. *Id.* at 49-50, 713 P.2d at 488.
243. 12 Kan. App. 2d 422, 747 P.2d 183 (1987).
244. *Id.* at 423, 747 P.2d at 185.

pay a guaranteed royalty and made the lessees responsible for damage to growing crops. The lessors claimed liens based on crop damage and unpaid guaranteed royalties. The court held that the lessors could not claim a lien under section 55-207 because that statute establishes liens only for those who provide labor and materials for oil and gas wells or pipelines.[245] Kansas does, however, recognize equitable liens, which arise when "one party advances money to another upon . . . an agreement by the latter to secure its payment by a mortgage upon specified lands," even if the agreement is not formally executed.[246] Assuming that the lessors in *Consolidated Oil* were entitled to an equitable lien, the question remained whether this equitable lien had priority over a mortgage that was previously filed formally under section 55-207. The statute states that liens created under its terms "shall be preferred to all other liens" that subsequently attach.[247] The court held that for a competing lien to be perfected, it must be definite in amount. Although the lease provision was definite regarding the identity of the lienor and the property subject to the lien, it was initially indefinite regarding amount because the lessors had no claim until they suffered actual loss or damage. The earliest moment that the lessors in *Consolidated Oil* could claim loss was when unpaid royalties first became due. Because this moment arrived only after Consolidated's lien had been filed, the lessors' lien was subordinate.[248] The lessors could point to no authority giving priority to an equitable lien over a valid statutory lien previously recorded. Even though section 55-207 was not the source of the lessors' lien, the statute still controlled in giving priority to Consolidated's lien.

## IX. RELATIONSHIPS GIVING RISE TO A FIDUCIARY DUTY

Many relationships in the production of oil and gas are marked by implied duties owing from one party to another. The duties owing from lessee to lessor,[249] from executive to nonexecutive,[250] and from lease assignee to the holder of an overriding royalty interest[251] have been the subject of much litigation and discussion.

245. *Id.* at 425, 747 P.2d at 186.
246. *Id.*
247. *See id.*
248. *Id.* at 426, 747 P.2d at 186-87.
249. *See* 5 H. WILLIAMS & C. MEYERS, *supra* note 5, § 801. *See generally id.* §§ 801 to 861.5.
250. *See* 2 *id.* § 339.2.
251. *See generally id.* § 420.

In two cases from the survey period,[252] the rights of the parties turned on the scope and extent of implied duties deriving from the parties' relationship.

One of the plaintiffs in *First National Bank & Trust v. Sidwell Corp.*[253] was a petroleum geologist who had studied a certain geographical area for oil and gas development. He later entered into an agreement that, in part, required the defendants to assign a one-fourth interest in leases acquired by the defendants in that area. Subsequently, the defendants acquired interests in certain leases without notifying the plaintiffs and without assigning a one-fourth interest in the leases to the plaintiffs. The Kansas Supreme Court termed the arrangement a joint venture,[254] noted that joint ventures create a fiduciary relationship among the parties under Kansas law,[255] and affirmed the trial court's conclusion that the defendants' actions constituted a breach of fiduciary duty.[256] The court further held that a constructive trust should be imposed on lease interests acquired by the defendants.[257] Express language of the agreement defined the parties' relationship as "independent contractors," but the court noted that a party can be simultaneously an independent contractor and an agent for another.[258] The court rejected the defendants' assertion that the agreement applied only to "undeveloped acreage" and not to producing properties because the agreement expressly applied to "any leases on any of such lands."

The defendants argued that particular language in an operating agreement covering part of the premises precluded one of the leases from being included in the court's order of a constructive trust. The defendants pointed to a provision of the operating agreement that stated that any lease executed more than six months after the expiration of an existing lease will not be regarded as a renewal lease and will not be subject to the agreement. One of the leases expired on October 5, 1976, and was renewed more than six months

252. First Nat'l Bank & Trust Co. v. Sidwell Corp., 234 Kan. 867, 678 P.2d 118 (1984); Short v. Cline, 234 Kan. 670, 676 P.2d 76 (1984).

253. 234 Kan. 867, 678 P.2d 118 (1984).

254. *Id.* at 872, 678 P.2d at 124. A joint venture has been defined as "a special combination of two or more persons devoted to a specific enterprise in which profit is jointly sought without actual partnership or corporate designation." Opco, Inc. v. Scott, 321 F.2d 471, 473 (10th Cir. 1963).

255. *First Nat'l Bank & Trust*, 234 Kan. at 875, 678 P.2d at 126 (citing Martin v. Hunter, 179 Kan. 578, 585, 297 P.2d 153, 158 (1956) (defining the nature of the duty)).

256. *First Nat'l Bank & Trust*, 234 Kan. at 875, 678 P.2d at 126.

257. *Id.*

258. *Id.* at 872, 678 P.2d at 124 (citing RESTATEMENT (SECOND) OF AGENCY § 2(3) (1957)).

later. The defendants argued that this lease should therefore not be subject to a constructive trust. The court rejected this argument. As a factual matter, the lease was not in the geographic area covered by the particular operating agreement. In addition, because the defendants breached their fiduciary duty by failing to disclose their acquisition of the original lease, the defendants were now estopped from invoking the particular provision of the operating agreement regarding renewal.[259]

The defendants' failure to disclose was particularly offensive because they had utilized valuable and confidential geological information generated by the plaintiff.[260] In any event, the joint venture relationship created a duty of "full, fair, open and honest disclosure of everything affecting the relationship."[261] The defendants breached this duty by failing to disclose their acquisition of the original lease and therefore held the subsequent lease under constructive trust for the plaintiffs.

The facts of *Short v. Cline*,[262] also decided during the survey period, present an uncommon case in which a single party holds two distinct and independent capacities. The plaintiff was both the reversioner following term royalty interests and the owner of the working interest. He brought suit to quiet title, claiming that the defendants' term royalty interests had terminated for lack of production. The defendants' interests were to last for as long as a particular sand was "being produced and operated." After these term interests were created, a pooling agreement was formed to include the west half of the involved premises. The term royalty owners executed the agreement, but the plaintiff's predecessor as reversioner did not. Subsequently, the plaintiff purchased the working interest of the oil and gas leases included in the pooling agreement. When the plaintiff later acquired the reversionary interest following the term royalty interests, he was able not only to control the duration of the defendants' term interests, but also to receive the benefits of their termination. Production on the premises ceased by November 1977, but unit production continued.

The defendants argued that the unit production was sufficient to sustain their term interests. The plaintiff responded that because his predecessor had not executed or consented to the pooling agreement and because the lease did not expressly authorize pooling, the unit production was not sufficient to sustain the lease or

259. *First Nat'l Bank & Trust*, 234 Kan. at 874-75, 678 P.2d at 126.

260. *Id.* at 875, 678 P.2d at 126.

261. *Id.* (quoting from Martin v. Hunter, 179 Kan. 578, 585, 297 P.2d 153, 158 (1956)).

262. 234 Kan. 670, 676 P.2d 76 (1984).

the term royalty interests. The issue presented by the plaintiff was whether "a determinable royalty interest can be pooled without the consent of the owner of the reversionary interest."[263]

The court disregarded this issue, however. Instead, the court focused on the plaintiff's duties deriving from his concurrent status as reversioner and operator. The court did not clearly state whether the plaintiff's duties were fiduciary in nature. It indicated that unlike a fiduciary,[264] the plaintiff had the right to act for the "mutual benefit" of the parties[265] and was not required to subordinate his interests to those of the term royalty interest owners. Ultimately, however, the court cited the principle that "one who seeks equity must do equity"[266] and concluded that it would be inequitable to allow the plaintiff to obtain termination of the defendants' interests for lack of production when he was the very party responsible for the cessation of production.[267] The court held that the defendants' term interests had therefore not terminated.

## X. PARTITIONABILITY OF AN OVERRIDING ROYALTY INTEREST

A cotenant of real property generally has a right to partition.[268] The equities of the particular case may determine whether the partition is to be by sale or in kind[269] but generally they do not affect whether partition is available.[270] Partition is generally not applicable, however, to nonpossessory interests.[271]

In *Muslow v. Gerber Energy Corp.*,[272] the plaintiffs sought to partition their undivided shares of the working interests under

263. *Id.* at 676, 676 P.2d at 81.

264. *See* I A. SCOTT & W. FRATCHER, THE LAW OF TRUSTS § 2.5 (4th ed. 1987).

265. *Short*, 234 Kan. at 678, 680, 676 P.2d at 82, 83.

266. *Id.* at 679, 676 P.2d at 83.

267. *See id.* at 680, 676 P.2d at 84.

268. 2 H. WILLIAMS & C. MEYERS, *supra* note 5, § 506.2.

269. *Id.*

270. In some jurisdictions, fraud and oppression may be established as an affirmative defense to partition. *See, e.g.*, KAN. STAT. ANN. § 60-1003(d) (1983). ("The court . . . may refuse partition if the same would result in extraordinary hardship or oppression."); Holland v. Shaffer, 162 Kan. 474, 482, 178 P.2d 235, 241 (1947); *see also* Schnitt v. McKellar, 244 Ark. 377, 391, 427 S.W.2d 202, 210 (1968); Henson v. Bryant, 330 P.2d 591, 592-93 (Okla. 1958).

271. R. HEMINGWAY, *supra* note 3, § 3.3, at 105 ("In cases involving mineral interests it is generally held that owners of nonpossessory interests in the minerals, by themselves, have no right to partition. Such nonpossessory interests would include ownership of landowner's royalty, overriding royalty, production payments, etc., as well as leases in nonownership jurisdictions."); *see also* 1 Oil & Gas Rep. (P-H) 489, 490 ("A royalty owner is not entitled to partition against another royalty owner, because their estates are not possessory.").

272. 237 Kan. 58, 697 P.2d 1269 (1985).

certain leases, with the partitioned shares to remain subject to the existing royalty and overriding royalty interests. The defendant, who owned a one-eighth share of the working interests, asserted that the overriding royalty interests also should be partitioned. The question before the Kansas Supreme Court was whether an overriding royalty interest could be partitioned along with the undivided shares of the working interest. The court referred to the general rule that "all property capable of being held in cotenancy is subject to partition by judicial proceedings."[273] The court also recognized that partition requires unity of possession, such that the owner of each interest has the right to occupy the whole with the owners of the other interests.[274] The court noted that an overriding royalty interest does not entitle the owner to possessory rights in the leasehold, nor does the owner share a tenancy in common with the owner of a royalty interest or the owner of the working interest.[275] Partition does not require that the different interests be of equal value or proportion. The interests must, however, be of equal dignity in terms of possessory rights.[276] As the court stated in *Muslow*, it is necessary that the various interest owners "be cotenants of what is proposed to be partitioned."[277] Because the overriding royalty interest owner is not a cotenant in the leasehold, the overriding royalty interest was held to be not subject to partition by the owners of royalty interests or the working interest.[278]

## XI. EXTINGUISHMENT OF ROYALTY INTERESTS BY SUBSEQUENT DEED

Kansas law assumes that a conveyance of real property includes all of the grantor's interest in the property unless the deed expressly states otherwise.[279] *Hall v. Mullen*[280] raised the question of whether

273. *Id.* at 62, 697 P.2d at 1273.

274. *Id.*

275. *Id.*

276. R. HEMINGWAY, *supra* note 3, § 3.3.

277. *Muslow*, 237 Kan. at 62, 697 P.2d at 1273 (citing Witt v. Sheffer, 6 Kan. App. 2d 866, 636 P.2d 195 (1981), *review denied*, 231 Kan. 802 (1982)).

278. *Muslow*, 237 Kan. at 63, 697 P.2d at 1274. The court recognized that there may be exceptions to its holding: "Where the owner of the working interests attempts to defeat partition by carving nonpossessory overriding royalty interests out of the working interests, or creates an overriding royalty interest to stop development, drilling, or operation of a lease, partition may be an equitable necessity." *Id.*

279. KAN. STAT. ANN. § 58-2202 (1983); Hall v. Mullen, 234 Kan. 1031, 1040-41, 678 P.2d 169, 176 (1984) (citing Fast v. Fast, 209 Kan. 24, 496 P.2d 171 (1972)).

280. 234 Kan. 1031, 678 P.2d 169 (1984).

certain deeds conveyed the grantors' royalty interests. *Hall* involved six siblings who were parties to a royalty pooling agreement that included a particular half section in which they held an equitable interest. Under the terms of the pooling agreement, two of the siblings each had an option to purchase a quarter section of the particular tract, with the purchase price to be based on "agricultural and grazing value only" and not to reflect oil and gas rights. In accordance with the pooling agreement's terms, three of the siblings executed a quitclaim deed conveying the northeast quarter section to their brother Robert Hall, and the other three joined in a warranty deed conveying the same tract to Robert. Shortly thereafter, Robert conveyed to his siblings a five-sixths term interest in the mineral estate under the northeast quarter section; all parties agreed that this interest had expired. Edith Hall, Robert's successor in interest, brought an action to quiet title, claiming that the five siblings relinquished any rights from the royalty pooling agreement by executing the quitclaim and warranty deeds. The five responded that these deeds conveyed only surface rights, as reflected by the reduced price that they received in exchange. The court agreed with Edith Hall and held that the quitclaim and warranty deeds extinguished all rights deriving from the pooling agreement.[281] The reduced price reflected only the anticipated conveyance of the term mineral interest. The court stated that when the quitclaim deed was executed, the only interest owned by the conveyors was their interest in the royalty pooling agreement.[282] As to the warranty deed, the court referred to a Kansas statute[283] providing that deeds are presumed to include all of the grantor's interest unless expressly stated otherwise. The warranty deed did not reserve any interest in royalties or make any reference to the pooling agreement. The court concluded that by executing the quitclaim and warranty deeds, Robert's siblings intended to relinquish their rights in the royalty pooling agreement in exchange for the now-expired term mineral interest.[284]

## XII. CONSTRUCTION AND APPLICATION OF CERTAIN POSTLEASE AGREEMENTS

*Holly Energy, Inc. v. Patrick*[285] involved the construction and application of a farmout agreement. The agreement stated that if

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281. *Id.* at 1043, 678 P.2d at 177.
282. *Id.* at 1040, 678 P.2d at 176.
283. *Id.* at 1040-41, 678 P.2d at 176 (citing KAN. STAT. ANN. § 58-2202 (1983)).
284. *Hall*, 234 Kan. at 1042, 678 P.2d at 178.
285. 239 Kan. 528, 722 P.2d 1073 (1986).

Patrick commenced construction of a well within ninety days of the agreement and completed the well to production, Holly Energy would convey to Patrick its lease rights "in that portion of the captioned quarter section situated within the production unit established for that well," subject to a 22.5 percent overriding royalty interest to be retained by Holly Energy. Patrick drilled a successful well on each of two different leases, and Holly accordingly assigned its lease rights to Patrick. When Patrick later drilled additional wells on those two leases, Holly Energy claimed that Patrick had gone beyond the scope of their agreement because the agreement entitled Patrick only to one well per lease and to the forty acres attributable to that well. Holly Energy pointed to the express language of the agreement that limited Patrick's interest to a "production unit," which Holly Energy contended was a well-defined term. Because the area was governed by forty-acre spacing, Holly Energy asserted that Patrick was entitled to work only forty acres per lease. Patrick claimed that his rights extended to a full quarter section, which he had the right to develop in accord with forty-acre spacing.

The court agreed with Patrick and held that the term "production unit" was not determinative of Patrick's rights. The court felt that the ambiguity of the term was demonstrated by disagreement at trial among expert witnesses on the meaning of the term.[286] The court referred to certain language in the lease that seemed to contemplate the drilling of more than one well.[287] The court noted that the terms of the agreement did not expressly limit Patrick to drilling only one well per quarter section and did not limit his rights to forty acres, even though it would have been a "simple matter" for Holly Energy to include such limitations expressly in the agreement.[288] The court also referred to evidence that no reasonably prudent operator under similar circumstances would have accepted a farmout agreement that offered only forty acres per lease.[289] The *Holly Energy* court determined that the burden was on Holly Energy to limit Patrick's rights more expressly.

In *Kennedy & Mitchell, Inc. v. Anadarko Production Co.*,[290] the Kansas Supreme Court construed and applied a "market-out" provision of a gas purchase contract. A market-out clause generally allows the gas buyer to lower its purchase price to reflect current

286. *Id.* at 536, 722 P.2d at 1079.
287. *Id.* at 531-32, 722 P.2d at 1076.
288. *Id.* at 536, 722 P.2d at 1079.
289. *Id.* at 537, 722 P.2d at 1079.
290. 243 Kan. 130, 754 P.2d 803 (1988).

market conditions, leaving the seller with the option of accepting the reduction or cancelling the contract.[291] The particular language of the market-out clause involved in *Kennedy & Mitchell, Inc.* allowed the seller thirty days either to accept or to reject the buyer's proposed reduction. Upon rejection by the seller, the buyer was required to release the seller's gas from the terms of the contract. In accordance with this clause, the buyer notified the seller of a proposed price reduction, and the seller failed to respond. The buyer therefore submitted a cancellation agreement to the seller for execution. The seller denied the buyer's authority to redetermine the purchase price and demanded that the buyer pay the original contract price.

The issue before the Kansas Supreme Court was whether the market-out clause gave the buyer the unilateral power to reduce the purchase price. The court cited several authorities supporting the buyer's position.[292] According to these authorities, the buyer has the right to invoke the market-out clause unilaterally, unless the market-out clause expressly states otherwise.[293] The court examined the particular clause and concluded that it contained no express restrictions on the buyer's right to redetermine the purchase price.[294] The purchase agreement included a clause allowing each party access to the other's books and records to verify any claims made under the agreement, but this was not a restriction on the buyer's rights under the market-out clause.[295] The court concluded that the buyer's actions were in accord with the gas purchase contract.

## XIII. CONSTRUCTION AND VALIDITY OF CERTAIN ADMINISTRATIVE ACTIONS

Much of the regulation of oil and gas drilling and production is done by the rulings and actions of administrative agencies. Courts will generally sustain an administrative action or ruling if it is supported by substantial and credible evidence or if it is not arbitrary or capricious.[296] The action or ruling must also be based on statutory authority.[297]

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291. *Id.* at 133, 754 P.2d at 806; *see also* 8 H. WILLIAMS & C. MEYERS, *supra* note 5, § 547; R. HEMINGWAY, *supra* note 3, § 7.4.

292. *Kennedy & Mitchell, Inc.*, 243 Kan. at 133-35, 754 P.2d at 806-07.

293. *Id.* at 134, 754 P.2d at 806.

294. *Id.* at 135, 754 P.2d at 807.

295. *Id.* at 135-36, 754 P.2d at 807.

296. *See* KAN. STAT. ANN. § 77-621(c)(7)-(8) (1984).

297. *See* Pork Motel, Corp. v. Kansas Dep't of Health & Env't, 234 Kan. 374, 378, 673 P.2d 1126, 1132 (1983). ("Administrative agencies are creatures of statute and their power is dependent upon authorizing statutes, therefore any exercise of authority claimed by the agency must come from within the statutes.")

In *Malone Oil Co. v. Department of Health and Environment,*[298] the Kansas Supreme Court determined the validity of a fine imposed under Kansas Administrative Regulation 28-16-27[299] by the Kansas Department of Health and Environment for the plaintiff's failure to report a salt water spill. The court concluded that there was no statutory or regulatory authority for the Department's action. The court first considered whether regulation 28-16-27 required the plaintiff to report the salt water leak to the Department. That regulation applied to persons "responsible for the discharge of sewage or other materials detrimental to the quality of waters of the state" and required that the "accidental discharge of sewage or other materials detrimental to the quality of waters of the state" be reported immediately to the state department of health.[300] The Department asserted that this regulation was authorized by section 65-171d of Kansas Statutes Annotated, which stated that the "storage or disposal of salt water, oil or refuse in surface ponds shall be prohibited unless a permit for such storage or disposal shall first be obtained" from the department.[301] The court concluded that the seepage of salt water from a cracked pipe in an injection well system could not be regarded as the storage or disposal of salt water in a surface pond and therefore did not require a permit under section 65-171d.[302]

This conclusion should have been dispositive of the case, but the court also examined regulation 28-16-27 and its requirement that persons responsible for the "discharge" of sewage or other harmful materials report such discharge to the department of health.[303] The court did not believe that the term "discharge" applied to a situation in which salt water escaped through cracks in an injection well system.[304] The court further believed that regulation 28-16-27 applied only to the disposal of sewage and not

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298. 234 Kan. 1066, 677 P.2d 546 (1984).

299. KAN. ADMIN. REGS. 28-16-27 (1986) provided, in part:

> The owner or person responsible for the discharge of sewage or other materials detrimental to the quality of waters of the state, under conditions other than provided for by a valid permit issued by the secretary of the state board of health, shall report such discharge to the state department of health, environmental health services. . . . Emergency or accidental discharge of sewage or other materials detrimental to the quality of waters of the state shall be immediately reported to the state department of health by the owner of the treatment plant or his representative.

300. *Malone Oil Co.*, 234 Kan. at 1071-72, 677 P.2d at 551.

301. *Id.* at 1070, 677 P.2d at 550 (quoting KAN. STAT. ANN. § 65-171d).

302. *Malone Oil Co.*, 234 Kan. at 1071, 677 P.2d at 550.

303. *Id.* at 1071, 677 P.2d at 550-51.

304. *Id.* at 1072, 677 P.2d at 551.

to "classes of activity wholly unrelated to the discharge of sewage."[305] The court concluded that the seepage of salt water in this case was not governed by regulation 28-16-27 and that the plaintiff was under no duty to report the salt water spill to the department.[306] Even if section 65-171d authorized the regulation of salt water spills, the court held that regulation 28-16-27 was not such a regulation.[307]

*Zinke & Trumbo, Ltd. v. Kansas Corporation Commission*[308] involved a direct challenge to the validity of a particular basic proration order. The order called for 160-acre spacing and applied a fifty-fifty formula, basing fifty percent of each well's allowable on its adjusted open flow and the other fifty percent on the acreage attributable to that well. Zinke argued that the order failed to protect its correlative rights because the order would allow Sho-Bar Energy, a neighboring producer, to "take an undue proportion of the obtainable gas" and would "cause undue drainage between developed leases."[309] Zinke particularly emphasized that Sho-Bar's recent fracture treatment increased its open flow by a factor of five.[310] Because of the high porosity and permeability of the area, the attribution of such great weight to open flow would allow Sho-Bar to drain unfairly from Zinke's lease and to produce far more than the six percent of the reservoir underlying Sho-Bar's lease.[311] The Kansas Supreme Court agreed with Zinke and held that evidence of the fracture treatment should have been considered by the Kansas Corporation Commission.[312] The order failed to show that the Commission took Sho-Bar's fracture treatment into account and was therefore unreasonable.[313] The court also agreed with Zinke's contention that the order should not have included certain acreage that contained no production from the particular formation.[314] The court also held that the Commission improperly ignored expert testimony that three separate reservoirs existed in

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305. *Id.* at 1073, 677 P.2d at 551.

306. *Id.* at 1073, 677 P.2d at 552.

307. *Id.*

308. 242 Kan. 470, 749 P.2d 21 (1988).

309. *Id.* at 473, 749 P.2d at 24 (quoting from KAN. ADMIN. REGS. 82-3-101(a)(15) (Supp. 1986)).

310. *Id.* at 478, 749 P.2d at 27. It is puzzling why this fracture treatment did not provide the basis for claims of trespass and conversion in view of the fact that "the fracture obviously penetrated Zinke's lease." *Id.* at 477, 749 P.2d at 27.

311. *Id.* at 479, 749 P.2d at 28.

312. *Id.*

313. *Id.* at 479-80, 749 P.2d at 28.

314. *Id.* at 481, 749 P.2d at 29.

the Morrow sand underlying the acreage covered by the order.[315] The expert witness testified that the proposed order included "three readily demonstrable distinct producing reservoirs."[316] Zinke argued that this violated section 55-703(a) of Kansas Statutes Annotated, which authorizes the Commission to regulate a gas field only if the field constitutes a common source of supply.[317] The court concluded that the Commission failed to make a proper finding that the field encompassed a common source of supply.[318] For all these reasons, the court concluded that the proration order was unreasonable and invalid.

Finally, the court addressed the validity of 160-acre spacing. Although the Commission found that the particular formation was "not unique," it ordered 160-acre spacing, rather than the 640-acre spacing that applied to other fields in the same sand. The court held that the Commission was required to support its order of 160-acre spacing with factual findings that distinguish the particular formation.[319]

*Northwest Central Pipeline Corp. v. Kansas Corporation Commission*[320] demonstrates the impact of federal regulation on the authority of state agencies. At issue was the validity of a Kansas Corporation Commission amendment to the basic proration order for the Hugoton gas field. Prior to the amendment, producers who produced less than their allowables were able to reinstate any cancelled underage without any time restrictions. The Commission determined that certain producers were accumulating excessively high cancelled underages and therefore amended the basic order in an attempt to reduce underages by imposing stricter time requirements on producers who wished to reinstate and produce their cancelled underages. Under the amendment, an underage not reinstated by a certain deadline would be cancelled permanently. A producer had sixty months after reinstatement within which to produce the reinstated underage.

The Kansas Supreme Court had earlier upheld the amendment as in compliance with section 55-703 of Kansas Statutes Annotated.[321] The court in that earlier decision rejected the argument

315. *Id.* at 489-90, 749 P.2d at 35.
316. *Id.* at 485, 749 P.2d at 32.
317. *Id.* at 490, 749 P.2d at 35-36.
318. *Id.* at 491, 749 P.2d at 36.
319. *Id.* at 481, 749 P.2d at 29.
320. 240 Kan. 638, 732 P.2d 775 (1987), *aff'd*, 109 S. Ct. 1262 (1989).
321. Northwest Cent. Pipeline v. Kansas Corp. Comm'n, 237 Kan. 248, 699 P.2d 1002 (1985). KAN. STAT. ANN. § 55-703 (Supp. 1988) provides that a producer of natural gas:

> may produce only that portion of all the natural gas that may be currently

that the primary purpose of the amendment was to encourage production, a purpose for which there was no statutory authority, rather than to protect correlative rights. The court was persuaded by the Commission's evidence that "the accumulation of underages . . . had rendered the field so out of balance it was seriously impairing the correlative rights of the landowners and operators."[322] The Commission's expert witness testified that there was no incentive under the original order to recoup cancelled underages within a reasonable time and this could ultimately result in the physical inability of the wells to recover their underages.[323] The court found that "there was substantial competent evidence to support the [Commission's] conclusion that correlative rights were being compromised by the excessive underages."[324] The court acknowledged that the Commission's functions did not include the selling of gas or the providing of incentives for additional production, but concluded that the Commission does have the authority to create incentives necessary to protect correlative rights.[325]

The United States Supremè Court later vacated this judgment and remanded[326] to the Kansas Supreme Court for reconsideration in light of the United States Supreme Court's 1986 decision in *Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Board ("Transco")*.[327] The issue on remand was whether the Kansas Corporation Commission's order improperly interfered with the federal regulation of natural gas in interstate commerce.[328] On remand, the Kansas court discussed *Northern Natural Gas Co. v. State Corporation Commission*,[329] a 1963 case in which the United States Supreme Court struck down a Kansas ratable take order as

> produced without waste and to satisfy the market demands, as will permit each developed lease to ultimately produce approximately the amount of gas underlying the developed lease and currently produce proportionately with other developed leases in the common source of supply without uncompensated cognizable drainage between separately-owned, developed leases or parts thereof.

The statute authorizes the Kansas Corporation Commission to "regulate the taking of natural gas from any and all common sources of supply within this state in order to prevent the inequitable or unfair taking of natural gas from a common source of supply. . . ." *Id.*

322. *Northwest Cent. Pipeline Corp.*, 237 Kan. at 261, 699 P.2d at 1014.

323. *Id.*

324. *Id.* at 264, 699 P.2d at 1016.

325. *Id.* at 265, 699 P.2d at 1016.

326. Northwest Cent. Pipeline Corp. v. Corporation Comm'n, 475 U.S. 1002 (1986).

327. 474 U.S. 409 (1986).

328. Northwest Cent. Pipeline Corp. v. Kansas Corp. Comm'n, 240 Kan. 638, 640, 732 P.2d 775, 777 (1987).

329. 372 U.S. 84 (1963) (discussed in *Northwest Cent. Pipeline Corp.*, 240 Kan. at 640-41, 732 P.2d at 777).

one "aimed directly at interstate purchasers" and which therefore undermined the comprehensive scheme intended by the Natural Gas Act.[330] The Kansas court then discussed the *Transco* case, which was decided in light of the Natural Gas Policy Act of 1978,[331] a statute that established a phased deregulation of natural gas prices. At issue in *Transco* was the validity of a Mississippi ratable take scheme. The United States Supreme Court held that the Oil and Gas Board's order was preempted by the Natural Gas Act and the Natural Gas Policy Act and disturbed the uniformity of the federal scheme by increasing the ultimate price of gas to consumers.[332] The United States Supreme Court concluded in *Transco* that the Natural Gas Policy Act did not "constitute a federal retreat from a comprehensive gas policy," even though the Natural Gas Policy Act provided that the provisions of the Natural Gas Act and the jurisdiction of the Federal Energy Regulatory Commission shall not apply to the "first sale" of high-cost gas or new natural gas.[333]

The Kansas Supreme Court in *Northwest Central Pipeline* interpreted *Northern Gas* and *Transco* as propounding a two-step test: (1) whether the amended order falls within the limits of a comprehensive federal regulatory scheme rather than within the category of regulatory questions reserved for the states, and (2) if so, whether the effect of the order will be to impair market forces.[334] The court held that the amended order was lawful and that the case was distinguishable from *Transco* because the amended order applied to gas producers, whereas the regulation in *Transco* applied to gas purchasers.[335] The court noted that the Natural Gas Act specifically excluded production and gathering from the jurisdiction of the Federal Energy Regulatory Commission.[336] The Kansas court recognized that change in rates of production of gas sold in interstate commerce has an effect on the interstate market, but the court said that the test was whether the regulation was "primarily directed" at the marketing of gas rather than at the production of gas.[337] The court confirmed its earlier conclusion that the primary effect of the amended order was to prevent waste and to protect the correlative rights of producers and concluded that

330. *Northwest Cent. Pipeline Corp.*, 240 Kan. at 641, 732 P.2d at 777.
331. 15 U.S.C. §§ 3301-3432 (1982).
332. *Northwest Cent. Pipeline Corp.*, 240 Kan. at 642, 732 P.2d at 778.
333. *Id.* at 642, 732 P.2d at 778.
334. *Id.* at 643, 732 P.2d at 778-79.
335. *Id.* at 645, 732 P.2d at 779.
336. *Id.* at 643-44, 732 P.2d at 779.
337. *Id.* at 645, 732 P.2d at 780.

the amended order's effect on interstate sales of gas was "merely incidental."[338]

## XIV. THE ACCRUAL OF INTEREST ON SUSPENDED ROYALTIES

Two cases from the survey period[339] dealt with interest on suspended royalties. Both cases involved class actions brought on behalf of royalty owners, some of whom did not reside in Kansas. The issues in *Shutts v. Phillips Petroleum Co.*[340] were whether the producer was obligated to pay interest on suspended royalties and, if so, the rate of such interest. Phillips withheld royalties while awaiting the Federal Power Commission's approval of a gas price increase. Approval was ultimately granted and Phillips paid the suspended royalties to the royalty owners, but did not pay interest. The Kansas Supreme Court initially[341] applied Kansas law[342] and held that general principles of equity required Phillips to pay interest to the royalty owners at the rates established by Phillips' corporate undertaking with the Federal Power Commission.[343] The court also imposed a postjudgment interest rate of fifteen percent per annum in accordance with Kansas law.[344] The court further held that Phillips was obligated to pay interest on royalties attributable to gas used by Phillips itself rather than sold.[345] The prime basis of the court's decision was that Phillips profited from the use of the funds withheld[346] and that to do so without compensating the royalty owners for such use would constitute unjust enrichment.[347]

Phillips appealed to the United States Supreme Court, which ruled[348] that the application of Kansas law to all of the class members' claims for interest violated the due process clause and

338. *Id.* at 646, 732 P.2d at 780.

339. Shutts v. Phillips Petroleum Co., 240 Kan. 764, 732 P.2d 1286 (1987), *cert. denied*, 108 S. Ct. 2883 (1988); Wortman v. Sun Oil Co., 241 Kan. 226, 734 P.2d 1190 (1987), *aff'd*, 108 S. Ct. 2117 (1988).

340. 240 Kan. 764, 732 P.2d 1286 (1987), *cert. denied*, 108 S. Ct. 2883 (1988).

341. 235 Kan. 195, 679 P.2d 1159 (1984), *aff'd in part and rev'd in part*, 472 U.S. 797 (1985).

342. The court stated: "The general rule is that the law of the forum applies unless it is expressly shown that a different law governs, and in case of doubt, the law of the forum is preferred." *Id.* at 221, 679 P.2d at 1181.

343. *Id.* at 217, 679 P.2d at 1178.

344. *Id.* at 224, 679 P.2d at 1183.

345. *Id.* at 217, 679 P.2d at 1178.

346. The court noted that "Phillips made substantial profit from the use of the suspense money during the period in question." *Id.* at 214, 679 P.2d at 1176.

347. *Id.* at 217, 679 P.2d at 1178.

348. Phillips Petroleum Co. v. Shutts, 472 U.S. 797 (1985).

the full faith and credit clause of the United States Constitution.[349] But the Court also held that there would be no harm in applying Kansas law "if it is not in conflict with that of any other jurisdiction connected to this suit."[350] On remand, the district court reviewed the laws of the other states involved and found no substantive conflict with Kansas law on the issues of liability and applicable interest rate. The Kansas Supreme Court affirmed[351] after reviewing in detail the substantive law of the other states[352] and comparing it to Kansas law. The court concluded that each of the jurisdictions would apply equitable principles of unjust enrichment to hold Phillips responsible for interest on the royalties held in suspense[353] at the interest rate prescribed by Federal Power Commission regulations.[354] The court also held that postjudgment interest should run from the district court's decision after remand from the United States Supreme Court at the statutory rate prescribed by the state where each lease was located.[355]

*Wortman v. Sun Oil Co.*,[356] addressed some of the same issues. The case was decided initially in 1984 by the Kansas Supreme Court,[357] and then a second time in 1987[358] on remand from the United States Supreme Court after its decision in *Phillips v.*

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349. The Kansas Supreme Court summarized the United States Supreme Court's holding as follows:

> Because Phillips had commingled the suspended royalties with its general corporate account, the [United States Supreme] Court found there was no specific identifiable res in Kansas, nor any limited amount to deplete before every plaintiff was compensated. The idea that all the plaintiffs consented to be bound by Kansas law when they failed to "opt out" of the suit was rejected because a plaintiff's desire is rarely, if ever, controlling on the choice of applicable law. Finally, the fact that a nationwide class action was being adjudicated and the requirements of procedural due process satisfied was found not to be a sufficient reason to apply the law of the forum.

Shutts v. Phillips Petroleum Co., 240 Kan. 764, 768, 732 P.2d 1286, 1291-92 (1987), *cert. denied*, 108 S. Ct. 2883 (1988).

350. *Phillips*, 472 U.S. at 816.

351. *Shutts*, 240 Kan. at 764, 732 P.2d at 1286.

352. Phillips briefed the law of only five of the other states involved. The court held that this constituted an "abandonment of any claim of error regarding jurisdictions other than the five states enumerated" and that Kansas law therefore would be regarded as applicable in the states that were not briefed. *Id.* at 798, 732 P.2d at 1311.

353. *Id.* at 800, 732 P.2d at 1312-13. The court also held that the principal amount owed to the royalty owners was sufficiently ascertainable to permit the accrual of interest. *Id.*

354. *Id.* at 800, 732 P.2d at 1313.

355. *Id.* at 801-02, 732 P.2d at 1314.

356. 241 Kan. 226, 734 P.2d 1190 (1987), *aff'd*, 108 S. Ct. 2117 (1988).

357. 236 Kan. 266, 690 P.2d 385 (1984), *vacated*, 474 U.S. 806 (1985).

358. *Wortman*, 241 Kan. at 226, 734 P.2d at 1190.

*Shutts*.[359] In its 1984 decision the Kansas Supreme Court held that the applicable interest rate on suspended royalties should be based on Sun Oil's corporate undertaking with the Federal Power Commission, rather than the statutory prejudgment rate of each state.[360] The court also determined that the action was not barred by the statute of limitations. Sun Oil collected price increases from July 1974 to April 1976 and paid royalties on the increased prices in July 1976. Sun Oil also collected price increases between December 1976 and April 1978 and paid royalties on the increased prices in April 1978. The action was filed in August 1979 on the theory of unjust enrichment. Sun Oil asserted that claims for interest on suspended royalties paid in July 1976 were barred by the three-year statute of limitations that governed actions based on implied contract.[361] The royalty owners argued that the arrangement was an open account, defined as:

> a connected series of debit and credit entries . . . where the parties intend that the individual items of the account shall not be considered independently but as a continuation of a related series . . . until it shall suit the convenience of either party to settle and close the account; and where . . . there is to be but one single and individual liability arising from such series of related and reciprocal debits and credits . . . .[362]

The court observed that with actions to collect on an open account, "the statute of limitations runs on the balance of the account, thereby tolling the statute until final payment is made."[363] The court concluded, however, that the arrangement between Sun Oil and the royalty owners did not constitute an open account.[364] The court noted that the July 1976 payments by Sun Oil "were for an amount of royalty suspended for a period of time and then paid out in a lump sum to each royalty owner" and that later monthly royalty payments had no relationship to the July 1976 payment.[365]

The court applied the "United States Rule," however, which provides that "in applying partial payments to an interest-bearing debt which is due, in the absence of an agreement or statute to contrary, the payment shall be first applied to the interest due, then to principal."[366] Thus, applying the July 1976 payment to

359. 472 U.S. 797 (1985).
360. *Wortman*, 236 Kan. at 269-70, 690 P.2d at 389.
361. *Id.* at 270, 690 P.2d at 390 (citing KAN. STAT. ANN. § 60-512).
362. *Wortman*, 236 Kan. at 271, 690 P.2d at 390 (quoting Spencer v. Sowers, 118 Kan. 259, 261-62, 234 P. 972, 974 (1925)).
363. *Wortman*, 236 Kan. at 271, 690 P.2d at 390.
364. *Id.* at 272, 690 P.2d at 391.
365. *Id.* at 271, 690 P.2d at 391.
366. *Id.*

interest first and then to the suspended royalties, the balance remaining after payment of interest was attributable to royalty. Because the royalty obligation was provided for in a written lease, a five-year statute of limitations applied and the action was therefore not barred.[367]

The United States Supreme Court later vacated and remanded for reconsideration in light of its decision in *Shutts*.[368] On remand, the district court concluded that the law of each of the other states comported with Kansas law in determining the prejudgment interest rate to be used. The district court determined that the other states would also apply the rate stated in Sun Oil's corporate undertaking with the Federal Power Commission.[369] On appeal, the Kansas Supreme Court affirmed, saying that *Shutts* was "controlling" on that issue.[370] Also in accord with *Shutts*, the Kansas Supreme Court held that the applicable postjudgment interest rate was the statutory rate for each state where the particular gas royalty was produced.[371] Finally, the court held that it was proper to apply the Kansas five-year statute of limitations, rather than the statute of limitations of each state, because statutes of limitations are remedial and procedural, rather than substantive.[372]

## XV. CONCLUSION

The Kansas cases from the survey period generally were consistent with prior authority. The courts took no new directions of major significance, nor did they offer any suggestions of dramatic reform. The survey period represents primarily a series of refinements of the established law.

367. *Id.*
368. Sun Oil Co. v. Wortman, 474 U.S. 806 (1985).
369. *Wortman*, 241 Kan. at 228, 734 P.2d at 1193.
370. *Id.* at 229, 734 P.2d at 1193.
371. *Id.*
372. *Id.* at 232, 734 P.2d at 1195.