Survey of Kansas Oil and Gas Law (1988-1992)

Phillip E. DeLaTorre*

Although the Kansas case law of oil and gas produced no landmark reforms during the last four years, the cases do contain several noteworthy developments.

I. APPLICATION OF CERTAIN LEASE PROVISIONS

Several cases during the survey period concerned the application of specific standard lease provisions. In three cases, the particular provision determined whether the lease continued to exist.1 In the other cases, the provision affected the amount of payment owing from the working interest owner2 to the lessor.3

In Rice v. Hillenburg,4 the Kansas Court of Appeals considered the application of an “unless-type” delay rental clause.5 A delay rental clause applies only during the primary term6 and generally

---

* Professor of Law, University of Kansas. B.A. 1975, University of Kansas; J.D. 1978, Harvard University. The author gratefully acknowledges the invaluable research assistance of Alan J. Stecklein, J.D. 1993, University of Kansas.


2. The working interest is the exclusive right, usually acquired by lease, to develop the minerals on the land. Howard R. Williams & Charles J. Meyers, Manual of Oil and Gas Terms 1377 (1991).


5. The clause stated:
   If operations for the drilling of a well for oil or gas are not commenced on said land on or before the 16th day of May, 1986, this lease shall terminate as to both parties, unless the lessee shall on or before said date pay or tender to the lessor the sum of One Hundred Sixty and no/100 Dollars, which shall operate as a rental and cover the privilege of deferring the commencement of operations for drilling for a period of one year. Id. at 156, 766 P.2d at 184.

6. The duration of the basic oil and gas lease is prescribed by the habendum clause, which 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. Unless the lease contains a delay rental clause, the lessee is generally assured that the lease will continue at least until the end of the primary term, even if the lessee performs no activities on the leased premises. Howard R. Williams & Charles J. Meyers, Manual of Oil and Gas Law § 606.2 (1992).
requires that the lessee commence operations for the drilling of a well by the first anniversary of the execution of the lease. In lieu of commencing a well, the clause allows the lessee to pay the lessor a specified amount, called a delay rental, on or before the anniversary date. This option is renewed on each anniversary of the primary term. When the lessee fails either to commence a well or to pay the delay rental, the consequences of this failure depend on whether the delay rental clause is an "unless-type" or an "or-type."

The unless-type delay rental clause limits the duration of the lease and makes payment of the delay rental a condition to the continuation of the lease. Failure to pay the delay rental by the anniversary date, therefore, results in automatic termination of the lease. Moreover, because the unless-type delay rental clause makes payment of the delay rental a limitation on the lessee's interest and not a covenant, the courts apply the clause strictly. If the lessee is a day late or a dollar short in payment, the result will generally be termination of the lease, regardless of the reason for the lack of payment. The courts, however, do recognize some exceptions. The Rice case discusses some of these exceptions.

In Rice, the lessee withheld payment of the delay rental pending the outcome of a third party's challenge to the lessors' right to lease to the lessee. This third party's challenge ultimately was rejected. The lessors then claimed, though, that because the lessee withheld delay rentals during the litigation, the lease terminated in accordance with the delay rental clause. The court of appeals

---

7. Another version of the delay rental clause requires the lessee to complete a well by the anniversary date.

8. In contrast, the obligation to pay the delay rental under an or-type delay rental clause is a mere covenant, not a limitation. Therefore, failure to pay will not result in termination of the lease. 3 Williams & Meyers, supra note 6, § 605.1. On the other hand, failure to pay under an unless-type delay rental clause does not generate contractual liability for breach, whereas failure to pay under the or-type delay rental clause does. Id. § 605.2. A typical or-type delay rental clause states: "Lessee agrees to commence a well on said premises within twelve months from this date or pay to Lessor ____ dollars each year, payable yearly thereafter until said well is commenced or this lease surrendered."

9. See, e.g., Morton v. Sutcliffe, 175 Kan. 699, 703, 266 P.2d 734, 737 (1954) ("[W]e are merely holding defendants to the contract they made."); Gasaway v. Teichgraebner, 107 Kan. 340, 341, 191 P. 282, 282 (1920) ("While forfeitures are abhorred by the law, this is not strictly a forfeiture, but a merely holding of a party to the contract it has made.").

10. 3 Williams & Meyers, supra note 6, § 606.3.

11. 13 Kan. App. 2d at 157, 766 P.2d at 184. The third party claimed that it owned the exclusive right to lease the premises and that the Rice-Hillenburg lease was therefore ineffective. The third party brought an action against Hillenburg to cancel the Rice-Hillenburg lease. The trial court upheld the Rice-Hillenburg lease, and the Kansas Court of Appeals affirmed. Id.
OIL AND GAS LAW 693

1993]

acknowledged the general rule of automatic termination for failure to make timely payment, but also noted that courts have recognized certain exceptions. According to the court, these exceptions include the situation "where the lessee attempted to make payment but the payment failed for some reason." The court held this exception inapplicable to the present facts, however, because the lessee made no attempt to pay the delay rental. The lessee invoked another recognized exception: "where the lessor attacked the lessee's title before the payment became due, and the attack had not been resolved at the time payment should have been made." The court in *Rice* held this exception also to be inapplicable because it requires that the attack on the lessee's title come from the lessor, whereas the attack in *Rice* came from a third party claiming superior lease rights.

Some Kansas cases have held the acceptance of late or inadequate tender of delay rental to constitute waiver by the lessor, resulting in the continuation of the lease. The lessor's acceptance of payment in those cases may be regarded as a voluntary and intentional renunciation of a claim or right. The key in those cases is that the lessor took the affirmative step of accepting late or inadequate payments. Waiver must be based either on some action by the lessor or by the lessor's lack of action when there is an obligation to act. In the *Rice* case, the court of appeals

13. *Id.* This statement is overbroad. Courts have excused failure to make timely and adequate payment when the failure is due to an entity independent from the lessee, such as the United States mail service or a depository bank. If the failure is due to the lessee's own fault, clearly the courts will apply the clause strictly. *E.g.*, Doornbos v. Warwick, 104 Kan. 102, 177 P. 527 (1919) (lessee failed to note that the lease expressly required payment in advance). Compare Kaye v. Little, 103 Kan. 461, 175 P. 149 (1918) (lease not terminated because late payment of delay rental was due to fault of the mail service).
17. 3 Williams & Meyers, *supra* note 6, § 606.6, 9.
18. A waiver is an intentional renunciation of a claim or right and exists only where there has been some absolute action or inaction inconsistent with that claim or right.

A waiver of a contract right implies a voluntary and intentional renunciation of it, and some positive act or positive inaction inconsistent with the contract right is necessary to create a waiver.

refused to find a waiver. The court noted that with an unlesstype delay rental clause, the lease terminates automatically upon failure to make timely payment of the delay rental. Because the lessors were not obligated to take any affirmative action to effect termination of the lease, their failure to act did not waive termination.

The Rice court also held estoppel inapplicable. The court set out the Kansas Supreme Court’s definition of estoppel:

The elements of equitable estoppel have been enumerated by our Kansas Court as follows: (1) There must have been a false representation or concealment of material facts; (2) it must have been made with knowledge, actual or constructive, of the facts; (3) the party to whom it was made must have been without knowledge or the means of knowing the real facts; (4) it must have been made with the intention that it should be acted upon; and (5) the party to whom it was made must have relied on or acted upon it to his prejudice.

The court found that the lessors made no false representations and concealed no material facts. Moreover, the court found that the lessee’s payment was not induced by the lessors.

Another clause that qualifies the duration of an oil and gas lease 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.” Without an operations clause, a lease will terminate at the end of the primary term if no production in paying quantities has yet resulted

21. Id.
22. Id. at 162, 766 P.2d at 187.
23. Id. (citing Place v. Place, 207 Kan. 734, 739, 486 P.2d 1354, 1358 (1971)).
24. Id. Some courts have applied estoppel in cases where the lessee attempts to make timely payment and the lessor, aware that the payment is improperly made or inadequate in amount, fails to notify the lessee of the mistake. See, e.g., Humble Oil & Refining Co. v. Harris, 205 S.W.2d 355 (Tex. 1947). See generally 3 Williams & Meyers, supra note 6, § 606.3.
26. This is an example of a well-completion clause, which is one of the two common types of operations clauses. An 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 well-completion clause (sometimes referred to as the drilling operations clause) sustains the lease only for as long as the lessee continues the same operations that were in progress when the primary term expired. 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 those that were in progress when the primary term expired. See generally 3 Williams & Meyers, supra note 6, § 617.2.
from the lessee’s efforts, regardless of the extent of the lessee’s good faith activities up to that point. An operations clause grants the lessee an extension of time to finish what the lessee started, provided that the lessee does so with reasonable diligence. This assumes, though, that the lessee was in the process of drilling operations when the primary term came to an end.

The issue in Petroleum Energy, Inc. v. Mid-America Petroleum, Inc. was whether the lessee’s primary-term activities were sufficient to constitute “commencement” of drilling operations. A literal application of the requirement to commence drilling operations would arguably require actual penetration of the earth’s surface with a drill bit. Most authorities today, however, do not apply a literal interpretation:

The general rule seems to be that actual drilling is unnecessary, but that the location of wells, hauling lumber on the premises, erection of derricks, providing a water supply, moving machinery on the premises and similar acts preliminary to the beginning of the actual work of drilling, when performed with the bona fide intention to proceed thereafter with diligence toward the completion of the well, constitute a commencement or beginning of a well or drilling operations within the meaning of this clause of the lease.

Such an approach leaves the courts with some discretion in determining the kind and extent of activity necessary to meet the requirement of commencement.

The parties in Petroleum Energy purported to define “commencement” by including the following language in their lease:

Drilling operations or mining operations shall be deemed to be commenced when the first material is placed on the leased premises or when the first work, other than surveying or staking the location, is done thereon which is necessary for such operations.

28. Id. at 1424. The clause, a well-completion clause, read:
If the lessee shall commence to drill a well or commence reworking operations on an existing well within the term of this lease or any extension thereof, or on acreage pooled therewith, the lessee shall have the right to drill such well to completion or complete reworking operations with reasonable diligence and dispatch, and if oil or gas, or either of them, be found in paying quantities, this lease shall continue and be in force with like effect as if such well had been completed with the term of years first mentioned.
Id. at 1423.
30. 2 W. L. Summers, THE LAW OF OIL AND GAS § 349 (1962); see, e.g., Wilds v. Universal Resource Corp., 662 P.2d 303 (Okla. 1983); see also 3 Kuntz, supra note 29, § 32.2; 3 Williams & Meyers, supra note 6, § 606.1.
31. 775 F. Supp. at 1423.
Nevertheless, the district court focused on the two traditional factors: (1) preliminary steps taken by the lessee in preparation for the commencement of actual drilling, and (2) the diligence of the lessee’s subsequent efforts in pursuing completion of the well.\textsuperscript{32} In finding that commencement had occurred prior to the end of the primary term, the court noted that the lessee had the leased premises staked, hired field contractors to prepare the site for drilling, and hired a drilling contractor all within the last ten days of the primary term.\textsuperscript{33} A notice of intention to drill was filed with the Kansas Corporation Commission during the last two weeks of the primary term. In addition, a rig was on site soon after the expiration of the primary term, and drilling operations commenced soon thereafter. Moreover, the court attached considerable significance to the fact that the lessee had made arrangements with a drilling contractor to perform drilling operations on the premises.\textsuperscript{34}

These activities did not take place until after or very near the end of the primary term. The court, however, cited authority holding that the requirement of timely commencement is satisfied if the lessee begins preparatory work, short of actual drilling, by the last day of the primary term.\textsuperscript{35} The late timing of the activities would seem to raise questions of good faith, but the courts express little concern about this. The Petroleum Energy court concluded that under the lease terms and applicable case law, the lessee’s activities qualified as commencement of drilling operations within the primary term.\textsuperscript{36}

\textsuperscript{32} Id. at 1424.

\textsuperscript{33} Id. at 1423-26.

\textsuperscript{34} Id. at 1425-26. The court distinguished Herl v. Legleiter, 9 Kan. App. 2d 15, 668 P.2d 200 (1983), on these grounds. The court in Herl held that the lessee’s activities did not constitute commencement of drilling operations. The Petroleum Energy court noted that the lessee in Herl had made no arrangements to obtain a drilling rig by the last day of the primary term. Thus, although actual drilling was not essential to the commencement of drilling operations, the acquiring of a drilling rig was a very important consideration. 775 F. Supp. at 1425-26.


\textsuperscript{36} Id. at 1426. As a result of the court’s conclusion, the original lease was still effective. The lessor therefore breached this lease by executing a second lease with another party. The court, however, held against the original lessee on all other issues: (1) the lessee was not entitled to damages for lost profits because they could not be established with reasonable certainty; (2) the lessee was not entitled to damages for development and site preparation expenses because the lessee would have incurred these expenses in any event, even if the lease had not been breached; (3) the lessor did not breach the covenant of quiet enjoyment by executing the second lease because such a breach occurs only if eviction
Pro-Chem, Inc. v. Lascetter Petroleum, Inc.\textsuperscript{37} involved the application of a cessation of production clause.\textsuperscript{38} A habendum clause typically requires continuous production to sustain the lease beyond the primary term. Lapse in production during the secondary term will generally cause termination of the lease.\textsuperscript{39} A cessation of production clause qualifies the habendum clause by allowing the lessee a certain time period following a cessation of production within which to resume production and thereby sustain the lease for as long as the resumed production continues. The clause in Pro-Chem read:

If . . . production . . . should cease from any cause after the primary term, this lease shall not terminate if Lessee commences additional drilling or re-working operations within sixty (60) days from the date of cessation of production or from date of completion of a dry hole.\textsuperscript{40}

The lessee had achieved production by the expiration of the primary term, but was forced to cease production temporarily because the saltwater disposal well it had been using became unavailable. The lessee found a new saltwater disposal site, but the site's location necessitated the rerouting of the saltwater disposal pipeline. The

occurs under paramount title existing at the time of the original conveyance; in Petroleum Energy the eviction was based on a belief that the original lease had expired and had therefore been superseded by a later lease; (4) the lessee had no claim for slander of title because the lessor and the second lessee acted under a good-faith belief that the original lease had come to an end and therefore the original lessee was unable to establish the malice required for a claim of slander of title; (5) similarly, the lessee had no claim for tortious interference with contract or tortious interference with a prospective business advantage because both of those torts require malice; (6) the lessee had no claim for civil conspiracy because the plaintiff failed to establish an independent, actionable tort; and (7) the lessee had no claim for trespass because the filing of a lawsuit asserting the validity of a competing lease does not constitute intentional entry onto the plaintiff's land, as required to establish trespass. \textit{Id.} at 1426-29.


38. \textit{Id.} at 86, 837 P.2d at 824. The typical cessation of production clause states:

If after the discovery of oil or gas the production thereof should cease from any cause, this lease shall not be terminated thereby if lessee commences drilling or reworking operations within sixty (60) days thereafter or (if it be within the primary term) commences or resumes the payment or tender of rentals on or before the rental paying date (if any) next ensuing after thirty (30) days following the cessation of production.

See generally 3 Williams & Meyers, supra note 6, \S 615.1.

39. The secondary term is the period subsequent to the expiration of the primary term during which the lease is continued in force by compliance with the thereafter clause of the lease. Williams & Meyers, supra note 2, at 1125. The thereafter clause typically provides for continued validity of the lease after the primary term so long as there is production in paying quantities. \textit{Id.} at 1270.

40. 17 Kan. App. 2d at 87, 837 P.2d at 825.
lessee finished rerouting the pipeline after a seventy-six day cessation.

The lessor conceded that the rerouting work was commenced within the sixty-day time limit prescribed by the cessation of production clause. The question was whether rerouting the saltwater disposal pipeline constituted "reworking operations" within the meaning of the cessation of production clause. The court described reworking as a term of art and defined it as "including, but not limited to, operations for and the reconditioning, deepening, plugging back, cleaning out, or repairing of any well or wells, or otherwise attempting in good faith to increase or restore production or discover new production." 41 The activities at issue, therefore, must be a good faith attempt to enhance or restore production and must be pursued with reasonable diligence. 42 The activities need not take place on the leased premises. 43 Despite the problems in constructing the new disposal well, 44 the court deemed the well to be a reasonably prudent alternative to transporting the saltwater by truck. 45 The court concluded that these activities were a good faith attempt to restore production and therefore constituted "reworking operations" within the meaning of the cessation of production clause. 46

In two other cases during the Survey period—Pan Oil & Gas Exploration, Inc. v. Kelt Kansas, Inc. 47 and Barker v. Boyer 48—the question was not the continued existence of the particular leases, but the calculation of payments owing from the working interest owner to the lessor. In both cases, the working interest owner had achieved production in paying quantities beyond the primary term. The lessors in Barker v. Boyer owned an undivided one-half interest in the mineral estate. The lessors purported to lease the entire interest. In addition to the standard royalty, the lease contained a typewritten provision by which the lessor reserved

41. Id. at 87, 837 P.2d at 825 (quoting from 3 Williams & Meyers, supra note 6, § 618.1).
42. Id. at 88, 837 P.2d at 824.
43. Id., 837 P.2d at 825-26.
44. Construction of the pipeline required the acquisition of right-of-way easements from three separate landowners. It also involved crossing a river. One of the landowners temporarily enjoined construction at one point, and at another point the working interest owners had to employ a new contractor. Id., 837 P.2d at 826.
45. Id. at 89, 837 P.2d at 826.
46. Id.
a "1/16 of 7/8 Override." The lease also contained a standard proportionate reduction clause, which stated:

If said Lessor owns a less interest in the above-described land than the entire and undivided fee simple estate therein, then the royalties and rentals herein provided shall be paid the Lessor only in the proportion which his interest bears to the whole and undivided fee. A proportionate reduction clause applies when the lessor's executive right is less than that claimed in the lease. In that event, the clause provides some protection to the lessee by reducing the royalty and rental obligations proportionately.

The question in Barker was whether an overriding royalty is proportionately reduced by a proportionate reduction clause. Such a clause can be expressly worded to cover overriding royalties, but in the absence of that, the question becomes whether the standard phrase "royalties and rentals" includes overriding royalties, thereby subjecting overriding royalties to the proportionate reduction clause. There is conflicting authority on this issue.

The court in Barker held the proportionate reduction clause inapplicable to the overriding royalty. In the court's view, the presence or absence of a proportionate reduction clause is irrelevant on the question of whether the overriding royalty should be proportionately reduced. Rather, that question turns solely on the wording of the instrument creating the overriding royalty. Thus,

49. Id. at 503, 794 P.2d at 323.
50. Id.
51. The proportionate reduction clause is also referred to as the lesser interest clause. See generally 2 Williams & Meyers, supra note 6, § 521.5.
52. The court states that "the lesser interest clause protects the lessee from double liability as to the royalty payments." 14 Kan. App. 2d at 505, 794 P.2d at 325 (citing Williams v. Sohio Petroleum Co., 151 N.E.2d 645 (Ill. 1958)). The court's premise on this is incorrect. Even in the standard case, with a nonconsenting covenentant, and in the absence of a proportionate reduction clause, the lessee is not responsible for two royalties. In addition to owing the lessor a royalty, the lessee owes the nonconsenting covenentant not a second royalty but a proportionate share of net production. Moreover, the effect of the proportionate reduction clause is not to eliminate totally the royalty obligation, but only to reduce it proportionately. The clause has no reducing effect whatsoever on the nonconsenting covenentant's proportionate share of net production.
53. Id. at 504, 794 P.2d at 324.
54. 4 Williams & Meyers, supra note 6, § 686.7.
56. Id. at 505, 794 P.2d at 325 (citing 3A Summers, supra note 30, § 609.2). The court stated that an overriding interest is acquired only by contract and is therefore payable only in the amount and only to the person designated by the contract. Id. at 505, 794 P.2d at 325 (citing Williams v. Sohio Petroleum Co., 151 N.E.2d 645 (Ill. App. 1958)). The court failed, however, to explain why this is any different from a royalty interest, which is just as much acquired only by contract and payable only in the amount and only to the person designated by contract.
the overriding royalty, if based on "oil produced under the terms of this lease," will be proportionately reduced if the lessor's executive or ownership rights are in fact more limited than what the lease claims, since the overriding royalty is expressly based on the interest being leased. But if the overriding royalty is based on "all oil produced from the described land," the assignor is expressly basing the overriding royalty on the entire amount of production, regardless of the extent of the lessor's ownership in the premises purportedly being leased. The overriding royalty will not be proportionately reduced in that event, even if the lease contains a proportionate clause.\textsuperscript{57} The clause in \textit{Barker} stated that the "Lessor reserves a 1/16 of 7/8 Override."\textsuperscript{58} The court held that this language was unambiguous, that the overriding royalty was based on production from the entire tract, and that the lessor was entitled to the full 1/16 of 7/8 overriding royalty without proportionate reduction.\textsuperscript{59}

This approach obviously places an emphasis on the wording of the instrument creating the override. It provides the lessor with the opportunity, by careful drafting, to exempt a 1/16 royalty from the effects of a proportionate reduction clause. Rather than calling for a 3/16 royalty that is entirely exposed to a possible proportionate reduction, the lessor can exempt a 1/16 amount simply by calling it an override and basing it on "all oil produced from the described land." To allow a lessor to exempt a 1/16 royalty by this tactic would seem entirely repugnant to the very purpose of a proportionate reduction clause.

In \textit{Pan Oil & Gas Exploration, Inc. v. Kelt Kansas, Inc.},\textsuperscript{60} the court confronted the argument that an "oil payment" entitled its owner to a share of gas, as well as oil, production.\textsuperscript{61} The court of appeals held that the term "oil payment" was ambiguous and not a term of art, and that the issue should be determined by an assessment of the parties' intent at the time of the transaction.\textsuperscript{62} The court remanded to the trial court, instructing it to consider

\textsuperscript{57} \textit{id.} at 506-07, 794 P.2d at 326.
\textsuperscript{58} \textit{id.} at 503, 794 P.2d at 323.
\textsuperscript{59} \textit{id.} at 508, 794 P.2d at 327.
\textsuperscript{61} \textit{id.} at 122, 833 P.2d at 137. A more generic term is "production payment," which is a cost-free fractional share of production that terminates when the accumulated payments reach an agreed amount. See Williams & Meyers, supra note 2, at 971. The agreement in \textit{Pan Oil} read: "This assignment is subject to an oil payment of $100,000.00 out of 1/16th of 7/8ths [working interest]." 17 Kan. App. 2d at 122, 833 P.2d at 137. The issue was whether this "oil payment" applied to gas and other hydrocarbons.
\textsuperscript{62} 17 Kan. App. 2d at 122-23, 833 P.2d at 137.
extrinsic evidence in order to ascertain the intent of the parties.63

II. IMPLIED DUTIES ARISING FROM CERTAIN OIL AND GAS RELATIONSHIPS

Many relationships in oil and gas are marked by implied duties owing from one party to another.64 The most basic of these relationships is that of lessor-lessee, which entails a well-established set of implied duties, including the duties to drill an initial exploratory well, to protect the leasehold from drainage, to reasonably develop the premises, to explore, and to market the resulting production.65 In Robbins v. Chevron U.S.A., Inc.,66 the Kansas Supreme Court dealt with the implied covenant to market, which requires the lessee to market the produced minerals at reasonable terms within a reasonable time following production.67 The lessors claimed that the lessee68 breached this implied covenant to market. The lessors sought cancellation of the leases and an accounting. The trial court granted the lessors summary judgment, finding that: (1) the lessee failed, as a matter of law, to market the gas with reasonable prudence for more than ten years, including a particular two-year period during which the lessee paid shut-in royalties;69 (2) the lessee imprudently failed to obtain favorable terms when it agreed to contract amendments that extended the gas sales contract beyond the original expiration date;70 and (3)

63. Id. at 124, 833 P.2d at 138. Part of the testimony available to the trial court on remand consisted of four affidavits filed earlier by the parties, one of which stated that "oil payment" includes both oil and gas, two of which stated that "oil payment" applies to oil only, and another of which stated that at the time of the assignment, test results indicated that the parties intended to cover gas in view of the positive test results of the completed gas well. Id. at 123-24, 833 P.2d at 138.

64. For example, the lessor-lessee relationship creates implied duties relating to drainage, development, exploration, and marketing. See 5 Williams & Meyers, supra note 6, §§ 801-822.5. The cotenancy relationship creates the duty to account when one cotenant develops the minerals unilaterally. 2 Williams & Meyers, supra note 6, § 504.1-.3. The duties owing from the executive to the nonexecutive are a matter of current debate. 2 Williams & Meyers, supra note 6, § 339.2.

65. See 5 Williams & Meyers, supra note 6, § 804.


67. 5 Williams & Meyers, supra note 6, §§ 853-858.3.

68. The original lessee was Gulf Oil Corporation, which later merged with Chevron U.S.A., Inc. The activities of both entities (collectively referred to herein as the lessee) were at issue in this case. 246 Kan. at 128, 785 P.2d at 1012.

69. Id. at 130-31, 785 P.2d at 1014.

70. The trial court felt that the take-or-pay provisions contained in the contract and amendment were imprudently inadequate; because the buyer's chief customer had become committed to another provider, the lessee might have anticipated that the buyer would be unable to take or pay for the plaintiff's gas. Id. at 131, 785 P.2d at 1014.
the lessee failed to pursue other buyers, even though it had become free to do so under the terms of the contract. The Kansas Supreme Court reversed and remanded, noting that a lessee's activities are measured by the standard of the reasonably prudent operator and are judged based on the circumstances existing at the time of the alleged breach. The court remarked that the question of compliance with this standard is primarily a question of fact. Upon assessing the facts, the court found nothing "patently imprudent" about the contract amendments and concluded that the amendments were within the bounds of reasonable prudence both as to their terms and as to their timing. As to the two-year lapse in marketing, the court noted that no alternate markets for the gas existed at the time. The court concluded that a sufficient factual question existed, and that summary judgment was therefore inappropriate, especially in light of the lessors' obligation to support their claim by expert testimony.

Anticipating that the lessors would prevail on remand, the court also discussed the question of remedies. The court confirmed the traditional view that forfeiture of an oil and gas lease for breach of an implied covenant is an extreme remedy that should be awarded only when damages cannot be determined with reasonable

71. The trial court noted: "Additionally the contract became vitiated by the absence and failure of Chevron to receive the price increases which were written into the contract by the 1978 amendment. At this point, certainly Chevron was left free to market the plaintiff's gas." Id. This was based on the terms of an express condition in the amended contract that the gas purchase contract would terminate if the Kansas Corporation Commission refused to approve any price increase called for by the contract. Id. at 127, 785 P.2d at 1012.

72. Id. at 131, 785 P.2d at 1014. The court noted that the lessee is bound by "what an experienced operator of ordinary prudence would do under the same or similar circumstances, having due regard for the interests of both." Id. (quoting Adolph v. Stearns, 235 Kan. 622, 626, 684 P.2d 372, 376 (1984)).

73. Id. at 133, 785 P.2d at 1016. The court commented that "second-guessing an operator's marketing decision" in light of "after-acquired knowledge" is inappropriate. Id. at 132, 785 P.2d at 1015 (citing 5 WILLIAMS & MEYERS, supra note 6, § 856.3).

74. Id. at 131, 785 P.2d at 1015 (quoting Adolph v. Stearns, 235 Kan. 622, 626, 684 P.2d 372, 376 (1984)).

75. The court observed that the contract amendments raised the sales price significantly, committed the buyer to a high take or pay arrangement, occurred at a timely moment when gas was in short supply and prices were rising, and were similar to terms that other producers in the same field were securing. Id. at 133, 785 P.2d at 1016.

76. The timing of the amendments was favorable to the lessor in the sense that gas was in short supply and prices were rising at the time of the amendments, and in the sense that the buyer and the buyer's chief customer both expected that the customer's demand for gas would remain high. Id.

77. Id.

78. Id. at 134, 785 P.2d at 1016.
The court also stated that cancellation in this case could be based only on breach of the implied covenant to market, and not on any of the express terms of the lease. Because the lessee had tendered shut-in royalty payments to the lessors during the shut-in period in accordance with the shut-in royalty clause contained in the lease, cancellation could not be based on the failure to produce gas during the shut-in period, contrary to the trial court’s order.

The relationship between the working interest owner and the holder of an overriding royalty interest was at issue in Lillibridge v. Mesa Petroleum Co. The essential facts of the case fit a familiar pattern: the lessee assigns the working interest in exchange for a 1/16 of 7/8 overriding royalty, the assignee subsequently (but while the original lease is still in effect) executes a “top lease” with the original lessor, after which the assignee allows the original lease to lapse for lack of production, thereby allowing the top lease to come into effect. The 1/16 of 7/8 overriding royalty, which was dependent on the continued existence of the original lease, is extinguished. The assignee thereby becomes a direct lessee, able to continue to exercise the operating rights but without the extra burden of paying an overriding royalty to an assignor. The main question in Lillibridge was whether such a transaction breaches any duty owing from the assignee to the assignor.

In Lillibridge, the Tenth Circuit, applying Kansas law, confirmed the general rule that the working interest owner owes no duty to the owner of an overriding royalty interest and has no obligation

79. Id.
80. Id. at 135, 785 P.2d at 1017.
81. Paragraph four of the lease stated:

The lessee shall pay lessor as royalty 1/8 of the proceeds from the sale of gas as such at the mouth of the well where gas only is found and where such gas is not sold or used, lessee shall pay or tender annually at the end of each yearly period during which such gas is not sold or used, as royalty, an amount equal to the delay rental provided in paragraph 5 hereof, and while said royalty is so paid or tendered this lease shall be held as a producing lease under paragraph 2 hereof.

Id.

82. Id.
83. 907 F.2d 1031 (10th Cir. 1990).
84. A “top lease” is a “lease granted by a landowner during the existence of a recorded mineral lease which is to become effective if and when the existing lease expires or is terminated.” See Williams & Meyers, supra note 2, at 1285.
85. 2 Williams & Meyers, supra note 6, § 418.2.
86. 907 F.2d at 1031.
to sustain the original lease. The court distinguished two Kansas cases that held the assignee liable in similar circumstances. The court distinguished Howell v. Cooperative Refinery Ass'n on the basis that Howell involved an express agreement between a geologist and an oil company that established a joint venture, thereby creating a confidential business relationship, a situation not applicable in the Lilibriddle case. The court distinguished Campbell v. Nako Corp. on the basis that the lessor and the assignee in Campbell engaged in fraud for the purpose of extinguishing the overriding royalty. The fraud consisted of extinguishing the overriding royalty in a court action without the overriding royalty owner's knowledge. The court also distinguished two cases from other jurisdictions. Both of those cases applied Oklahoma law, found that a fiduciary relationship existed between the assignor and the assignee, and determined that the assignee acted in bad faith. The essential point of the Lilibriddle opinion is that the assignment itself does not create fiduciary obligations owing from the assignee to the assignor. Fiduciary obligations must be based either on a confidential relationship, such as exists in a joint venture, or on the perpetration of fraud or collusion by the assignee.

The court in Lilibriddle also addressed whether the top lease constituted an "extension or renewal" of the original lease, thereby making it subject to the overriding royalty under the express terms of the assignment agreement. The court held that the top lease

87. Id. at 1036; see 2 Williams & Meyers, supra note 6, § 420.1.-2.
90. 907 F.2d at 1034. In Howell, the contract between the geologist and the oil company provided that they would attempt to acquire an oil and gas lease in the name of the geologist, who would then assign it to the company but reserve an overriding royalty; the oil company agreed to pay the bonus for the lease and to drill a well at a specified location. Id.
92. 907 F.2d at 1035.
93. Id. The Campbell court held that this met the definition of collusion as an agreement or secret arrangement among two or more persons to defraud a third person of his or her rights. Id.
94. Independent Gas & Oil Producers, Inc. v. Union Oil Co., 669 F.2d 624 (10th Cir. 1982); Probst v. Hughes, 286 P. 875 (Okla. 1930).
95. 907 F.2d at 1035.
96. Id. at 1036.
97. See id.
98. Id. at 1033. The assignment agreement expressly provided that the overriding royalty would apply to any "extension or renewal" of the original lease. Id.
was not an "extension or renewal" of the original lease because the two leases were materially different in several ways. Therefore, the language in the assignment agreement regarding "extensions" and "renewals" did not apply.

The relationship involved in Conner v. Koch Oil Co. was one of concurrent ownership of a mineral interest. When a concurrent owner develops minerals without the consent of his or her co-owner, the developing co-tenant has a duty to account to the nonconsenting co-owner for proportionate shares of net production. In Conner, the premises were initially leased out by Adair, the sole owner of the mineral estate. Subsequent to this lease, Adair conveyed an undivided one-half interest in the mineral interest to third parties. The lessees later incorporated and wished to hold ownership of their lease in their new corporate name. Accordingly, they released their lease and then acquired, from the third parties only, a new lease in the name of their new corporation. Adair did not participate in the new lease. She nevertheless continued to receive and accept royalty payments. When Adair died, the plaintiff acquired her estate's share of the mineral interest and thereafter continued to receive and accept royalty payments. Ultimately, the plaintiff brought this action as a nonconsenting co-tenant, seeking a proportionate share of net production. The issue was whether the releases should be reformed to exclude the plaintiff's undivided one-half interest, consistent with the belief of both Adair and the lessees that the releases did not apply to Adair's interest.

The Kansas Supreme Court categorized the situation as one of mutual mistake of fact and held that the releases should therefore be reformed to exclude Adair's undivided one-half interest. The

99. Id. at 1033, 1036. The top "lease" was actually five leases covering 160 acres each, whereas the original arrangement was a single lease covering all 800 acres; the top leases had three-year primary terms, whereas the original lease had a ten-year primary term; and the assignees paid new consideration in the amount of $130,200 for the top leases. Id. at 1033.


101. 2 WILLIAMS & METERS, supra note 6, § 504.1.

102. 245 Kan. at 254, 777 P.2d at 824. The lessees did not regard the releases as applicable to Adair because they were unaware that Adair had retained an undivided share of the mineral estate. Although Adair had constructive notice of the existence of the releases as a matter of basic agency law (based on the fact that her business manager placed copies of the releases in her file), she did not believe that the releases were applicable to her leased mineral interest. Id.

103. Id., 777 P.2d at 825. The court indicated that reformation would have been applicable even if the mistake had been unilateral to the lessees, because reformation is generally available to correct transfers of real estate without consideration. Id.
court further held that this reformation related back to the time of the original execution of the releases and was therefore binding on the plaintiff because the plaintiff was not a bona fide purchaser. 104 Finally, the court held that reformation was not barred by the five-year statute of limitations for reformation of contracts105 because the statute of limitations was not intended to bar the use of reformation as a defense, especially when no innocent third party had detrimentally relied on the mistaken instrument, as was the case in Conner. 106 Because the releases were reformed to exempt Adair's undivided one-half interest, 107 Adair remained a consenting cotenant on the lease to the lessees. As a result, the plaintiff, as Adair's successor, was entitled to royalties only and not to a proportionate share of net production.

In Waltrip v. Sidwell Oil & Gas, Inc., 108 the Kansas Supreme Court considered the duties owing between parties to a two-tiered investment arrangement. Woolsey and Read entered into an agreement by which each promised the other that upon the acquisition by either individual of a lease within a prescribed geographic area, the other would have the right to acquire an undivided interest in the lease. 109 To finance the venture, Read assigned shares of the working interest in the Woolsey-Read agreement to various individual investors, including George and Emma Hill. Read also retained an interest for himself. When Read and others acquired certain leases without partially assigning to Woolsey and without informing the other investors, Woolsey and others brought suit against them based on the Woolsey-Read agreement. In First National Bank & Trust Co. v. Sidwell Corp., 110 the Kansas Supreme Court held that the defendants had breached a fiduciary duty owing to the plaintiffs under the Woolsey-Read agreement. 111 In the Waltrip lawsuit, the successors of George and Emma Hill

104. Id. The plaintiff had not paid full value for the mineral interest. Id.
106. 245 Kan. at 255-56, 777 P.2d at 825-26. "Where parties have peacefully acted in accordance with what they understand and intend to be their rights, reformation is allowed as a defense to a suit to enforce the literal language of an instrument which through mistake does not evidence the intention of the parties, regardless of how many years have passed before the suit is brought." Id. at 256, 777 P.2d at 826.
107. Id. at 257, 777 P.2d at 826.
111. Id. at 875, 678 P.2d at 126.
claimed breach of a fiduciary duty based on the Read-Hill assignment.112 The trial court granted their motion for partial summary judgment on the basis that the defendants were collaterally estopped from relitigating the issues previously decided in the First National Bank case.113

The key issue before the Kansas Supreme Court in Waltrip was whether summary judgment was appropriate on the basis of collateral estoppel. The Kansas Supreme Court concluded that summary judgment was not appropriate, holding that the obligations owing as partners under the Woolsey-Read agreement were “not the same” as those owing to the Hills as working interest owners under the Read-Hill assignment.114 The court also described Woolsey’s rights under the Woolsey-Read agreement as “substantially different” from the Hills’ rights under the Read-Hill assignment.115 The court therefore held that the trial court improperly applied collateral estoppel in the Waltrip case.116

III. OIL AND GAS MECHANICS’ LIENS

A series of cases117 during the survey period dealt with the application of the Kansas oil and gas mechanics’ lien statute.118 Section 55-208 of the Kansas Statutes Annotated provides a lien to one who: (1) furnishes machinery or supplies to a subcontractor under a contractor; (2) performs labor under a subcontract with a contractor; or (3) is an artisan or day laborer employed by a

112. 245 Kan. at 58-59, 774 P.2d at 950-51. The successors of George Hill filed one action, and Emma Hill’s successors and other members of the Hill family filed another action; those two lawsuits were consolidated.
113. Id. at 59, 774 P.2d at 951-52.
114. Id. at 63, 774 P.2d at 953-54.
115. Id., 774 P.2d at 954. The court explained as follows:
While Woolsey was entitled to a 1/4th interest in any lease acquired by Read within the area of mutual interest, without cost to Woolsey, Read was entitled only to an option to purchase a 3/4ths interest in any such lease acquired by Woolsey by paying the bonus consideration and broker’s commission associated with the acquisition.
116. Therefore, the Hills’ rights, which were acquired from Read, were similarly limited.
The Kansas Supreme Court added a fourth category as a matter of statutory interpretation: (4) one who supplies materials to a contractor. The dispositive question in *Sfeld Engineering, Inc. v. Franklin Supply Co.* was whether the claimant Sfeld fit under any of the previous four categories. This, in turn, depended on the status of Franklin Supply Company. The lessee Mobil Oil Corporation had ordered three fiberglass water tanks from Franklin Supply, which was responsible for delivering the tanks to Mobil's lease sites and unloading them. Franklin Supply, in turn, ordered the tanks from Sfeld. Sfeld delivered the tanks, each of which came in two parts, to the lease sites. At the lease site, Sfeld bolted the parts together, lined the inside of the tanks with fiberglass, and installed fittings as directed by a Mobil employee. From that point, an independent party, F & O Roustabouts, installed the tanks and put them into operation. Sfeld filed mechanics' liens on Mobil's leases when Franklin Supply became bankrupt and unable to pay Sfeld.

The Kansas Supreme Court referred to *Interlake, Inc. v. Kansas Power & Light Co.* and cited that case's definition of a

---


> Any person, copartnership or corporation who shall furnish such machinery or supplies to a subcontractor under a contractor, or any person who shall perform such labor under a subcontract with a contractor, or who as an artisan or day laborer in the employ of such contractor, and who shall perform any such labor, may obtain a lien upon said leasehold for oil and gas purposes or any gas pipe line or any oil pipe line from the same tank and in the same manner and to the same extent as the original contractor for the amount due him or her for such labor, as provided in K.S.A. 55-207.

120. Mountain Iron & Supply Co. v. Branum, 200 Kan. 38, 41-43, 434 P.2d 1015, 1018-19 (1967). "It would, after all, be wholly illogical if protection were afforded to a materialman supplying a subcontractor but not to a materialman supplying a contractor. *Mountain Iron* represents basically a judicial correction of a statutory omission rather than an extension of the scope of the statute." Interlake, 231 Kan. at 254, 644 P.2d at 387.


122. Id. at 147, 795 P.2d at 62.

123. 231 Kan. 251, 644 P.2d 385 (1982). The court noted that the *Interlake* facts were similar to the *Sfeld* facts. 247 Kan. at 148, 795 P.2d at 62. In *Interlake*, Kansas Power & Light ordered materials from Continental Pipe for construction of a pipeline. Continental Pipe, in turn, purchased the pipe from Interlake and directed Interlake to ship the pipe to Plexco for coating. An independent party, J & B Construction, performed the actual construction of the pipeline. Upon completion of the pipeline, Kansas Power & Light paid Continental Pipe, but Continental Pipe failed to pay Interlake. The court held that Continental Pipe was a mere materialman and Interlake a supplier to a materialman, "a class so far removed from the owner that only the 'plainest expressions of law' must be used to entitle the class to lien protection." Id. (citing Interlake, 231 Kan. at 256, 644 P.2d at 389). For a discussion of *Interlake*, see Phillip E. DeLaTorre, Recent Developments in Kansas Oil and Gas Law, 32 KAN. L. REV. 595, 609-11 (1984).
materialman as "one who merely furnishes materials to the owner or a contractor is a materialman, and not a contractor or subcontractor, within the meaning of the mechanic's lien laws." The court concluded that Franklin Supply was merely a materialman to Mobil, not a contractor.

This should have been dispositive of the case. To deem Franklin Supply a materialman would seem to disqualify Sfeld from any of the four categories of those entitled to a lien. Neither the statute nor case law provides lien protection for one who contracts under or supplies a materialman. The court recognized that for Sfeld to qualify under Section 55-208, Franklin Supply must be found to be a contractor. To categorize Franklin Supply as a materialman would therefore seem to settle the question of Sfeld's rights to a lien, and Sfeld's activities would seem irrelevant.

Nevertheless, the court proceeded to evaluate Sfeld's activities, perhaps to preempt any notion that Sfeld qualified under Section 55-207 of the Kansas Statutes Annotated as a contractor directly under the lessee (Mobil). Sfeld delivered the parts to the lease sites, bolted the parts together, lined them with fiberglass, and installed fittings according to Mobil's directions. Because these activities did not, in the court's view, involve any construction and did not constitute substantial work, Sfeld was merely a supplier to the materialman Franklin Supply and therefore not entitled to a lien.

A trio of cases from the court of appeals also applied the oil and gas mechanics' lien statute. In all three cases, the question was whether the particular oil and gas mechanics' lien had priority over a particular competing encumbrance. The court in *D Oil, Inc. v. Brungardt* held that an operator's oil and gas mechanics'

---

125. *Id.*
126. *Id.*
128. 247 Kan. at 150, 795 P.2d at 63-64. The court of appeals also emphasized Sfeld's activities, particularly the process of placing the fittings on each tank at a point that would connect with the water line from each well. Unlike the supreme court, however, the court of appeals believed that Sfeld "did something more than merely furnish materials; it actually constructed with such materials (the tanks) some part of the structure." *Sfeld Eng'g, Inc. v. Franklin Supply Co.*, 14 Kan. App. 2d 81, 85-86, 782 P.2d 357, 360 (1989).
lien had priority over a mortgage that the working interest owner executed five years after the operator had commenced its work on the leased premises.\textsuperscript{131} The court gave priority to the operator's oil and gas lien even though the working interest owner was current on his payments to the operator at the time the mortgage was recorded.\textsuperscript{132} Thus, the operator need not even be a creditor prior to the attachment of the subsequent mortgage; the only consideration is whether the operator commenced its work prior to the attachment of the competing mortgage.\textsuperscript{133} The court based this conclusion on the wording of Section 55-207 of the Kansas Statutes Annotated,\textsuperscript{134} which expressly gives the oil and gas lien priority if the furnishing of the labor or supplies commenced prior to the attachment of the competing encumbrance.\textsuperscript{135} The court justified its conclusion as a literal application of the statute,\textsuperscript{136} and on the grounds that the specific oil and gas lien statute should control over the more general mechanics' lien statute.\textsuperscript{137} The court also cited the general policy behind the oil and gas lien statute of avoiding the windfall that the subsequent mortgagee would receive if the "first to file" rule were to apply.\textsuperscript{138}

\begin{flushleft}
\textsuperscript{131} \textit{See} \textit{id.} at 143-44, 764 P.2d at 852.
\textsuperscript{132} \textit{See id.}
\textsuperscript{133} \textit{Id.} at 143, 764 P.2d at 852.
\textsuperscript{134} Section 55-207 of the Kansas Statutes Annotated states, in part:
Such lien shall be preferred to all other liens, or encumbrances which may attach to or upon such leasehold for gas and oil purposes and upon any oil pipe line, or gas pipe line, or such oil and gas wells and the material and machinery so furnished and the leasehold for oil and gas purposes and the fixtures and appliances thereon subsequent to the commencement of or the furnishing or putting up of any such machinery or supplies.
\textsuperscript{136} 13 Kan. App. 2d at 143, 764 P.2d at 852.
\textsuperscript{137} "[T]he Supreme Court has indicated that K.S.A. 55-207 means exactly what it says: the lien has priority over any encumbrance attaching subsequent to the commencement of or furnishing of labor and materials." \textit{Id.} at 144, 764 P.2d at 852 (citing \textit{Moyer v. Hezlep}, 123 Kan. 735, 737, 257 P. 229, 230 (1927)).
\textsuperscript{138} \textit{Id.}
\end{flushleft}
The court of appeals applied the same approach in *Pioneer Operations Co. v. Brandeberry*. The claimant in *Brandeberry* began providing services one year before the working interest owner executed the competing mortgages and security interests, but the security interests were perfected before the claimant filed its mechanics' liens. Citing *D Oil*, the court held that the oil and gas mechanics' liens had priority over the mortgages and security interests. As in *D Oil*, the court recognized that the priority of the oil and gas lien is established at the time when labor or materials are first furnished, not when the lien is filed.

The court in *National Supply Co. v. Case Oil & Gas, Inc.* acknowledged one qualification to the statutory superiority of an oil and gas mechanics' lien. The court held the claimant's oil and gas mechanics' lien to be subordinate to a purchase money security interest in a pumping unit. The execution of the purchase money security interest occurred on the same day as the furnishing of materials and services that gave rise to the oil and gas mechanics' lien. The attachment of the security interest was therefore not "subsequent" to the commencement of the furnishing of materials and services, and the security interest was therefore not subordinate to the oil and gas mechanics' lien under a literal application of

140. The claimant was the operator of the property and furnished the working interest owner's operating expenses. *Id.* at 290, 789 P.2d at 1183.
141. *Id.* at 290-91, 789 P.2d at 1184.
142. *Id.* at 297, 789 P.2d at 1188.
143. *Id.* The court remanded, however, on the issue of the validity of the mechanics' liens. *Id.* at 298, 789 P.2d at 1188. In addition, the court rejected the claimant's quantum meruit claim against the competing mortgagee. *Id.* Claimant argued that the mortgagee was personally liable for the working interest owner's operating expenses and therefore was unjustly enriched by the claimant's payment of those expenses. The court held, though, that a mortgagee does not become personally liable for operating expenses unless the mortgagee is entitled to receive all of the revenues deriving from the production. *Id.* at 298-99, 789 P.2d at 1188-89. Therefore, the mortgagee in this case was not unjustly enriched by the claimant's payment of the working interest owner's operating expenses. *Id.* at 298-300, 789 P.2d at 1189 (citing 3 W.L. SUMMERS, OIL AND GAS § 557, at 707 (1958) and First Nat'l Bank v. Matlock, 226 P. 328 (Okla. 1924)).
145. *Id.* at 434, 772 P.2d at 1258.
146. *Id.* at 430-31, 772 P.2d at 1256. The date of attachment for the oil and gas lien is fixed by Section 55-207 of the Kansas Statutes Annotated as the date when the materials and services are first furnished by the lien claimant. KAN. STAT. ANN. § 55-207 (1983). The court in *National Supply Co.* rejected the claimant's argument that the liens of all claimants attach on the date when materials or services are provided by the first supplier. 13 Kan. App. 2d at 432, 772 P.2d at 1257.
Section 55-207 of the Kansas Statutes Annotated. Moreover, and more importantly, the court held that even if the purchase money security interest were subsequent to the commencement of the lien claimant's activities, the purchase money security interest would nevertheless be entitled to priority over the oil and gas mechanics' lien, despite the express language of Section 55-207 of the Kansas Statutes Annotated. The court's rationale was that "a lien can attach only to the extent of the interest of the party for whom the goods or services were provided."

Because the pumping unit in this case came into the hands of the working interest owner "already encumbered" with a purchase money security interest, the oil and gas mechanics' lien must necessarily be qualified by the security interest.

IV. Issues Pertaining to Pooling and Unitization

The case of Kneller v. Federal Land Bank of Wichita deals with the familiar question of the extent to which unit production sustains a term mineral interest. The scenario is that a pool or unit is formed to include part of a tract that is subject to a term mineral interest; production then occurs on the unit but not on any part of the tract that is subject to the term mineral interest. The question then is whether this on-unit off-tract production sustains any part of the term mineral interest.

The Kansas Supreme Court's treatment of this issue has been uneven. In Smith v. Home Royalty, the Kansas Supreme Court held that production on off-tract lands did not sustain a term mineral interest contained within the unit. The term mineral interest was not credited with unit production; for production to extend a defeasible term mineral interest, it was required that the production come from a well physically located on the tract.

147. Section 55-207 of the Kansas Statutes Annotated gives the oil and gas mechanics' lien priority over only those liens and encumbrances that attach "subsequent to the commencement of or the furnishing or putting up of any such machinery or supplies." 


149. Id., 772 P.2d at 1258.

150. Id. at 433-34, 772 P.2d at 1258 (quoting Chambers v. Nation, 497 P.2d 5, 7 (Colo. 1972)).


152. A term mineral interest is one of less than perpetual duration. It may be a fixed term (e.g., "for ten years") or a defeasible term (e.g., "for two years and then for so long thereafter as there is production from the premises"). Williams & Meyers, supra note 2, at 1265.


154. Id. at 614-15, 498 P.2d at 102-03.
Federal Land Bank of Wichita, the court modified this position to credit the on-unit part of a term mineral interest with unit production, although in a companion case, Friesen v. Federal Land Bank of Wichita, the court held that Smith continued to apply to the off-unit part of the term mineral interest.

The facts of Kneller fit within the scope of Classen. The prime question in Kneller was whether Classen should be applied retroactively, so as to entitle a term mineral interest owner to royalties for on-unit off-tract production that had been paid to the reversioners under the Smith rule. The court in Kneller held that Classen does not apply retroactively. The court reasoned that although the term mineral interest did not expire under pre-Smith

156. Id. at 435, 617 P.2d at 1262. The court in Classen stated that the Smith case was "disapproved" to the extent that it conflicted with this modification. Id. at 437, 617 P.2d at 1263.
158. Id. at 526, 608 P.2d at 918-19. The court thus employed the concept of divisibility of term mineral interests. This is contrary to the Texas and Oklahoma views regarding term mineral interests, both of which hold that on-unit off-tract production sustains the entire tract, including the off-unit part of the tract. See, e.g., Southernland Royalty Co. v. Humble Oil & Ref. Co., 249 S.W.2d 914 (Tex. 1952); Panhandle E. Pipe Line Co. v. Isaacson, 255 F.2d 669 (10th Cir. 1958) (applying Oklahoma law). This is also contrary to the Kansas position with regard to leases, which is that leases are indivisible and that on-unit off-lease production is sufficient to sustain the entire lease, including the off-unit part of the lease. Somers v. Harris Trust & Savs. Bank, 1 Kan. App. 2d 397, 566 P.2d 775 (1977). To be more generous with lessees than with term mineral interest owners on this issue is perhaps justifiable; to sustain the entire lease does not necessarily harm the lessor inasmuch as the off-unit part of the lease continues to be governed by the implied covenant of reasonable development. See Richard W. Hemingway, The Law of Oil and Gas 441 (3d ed. 1991).
159. 247 Kan. at 404, 799 P.2d at 489. The primary term of the term mineral interest expired on July 30, 1960. Prior to the expiration of the primary term, on-unit off-tract production was achieved and a proportionate share of royalties was paid to the term mineral interest owner. Smith was decided in 1972. A 1976 title opinion determined that the term mineral interest had terminated under the Smith holding, and the working interest owner thereafter paid all royalties on one well to the reversioners, suspended royalties on another well, and paid no royalties to the term mineral interest owners. Classen was decided in 1984, prompting a new title opinion that determined that the term mineral interest was still effective. Accordingly, the lease assignee paid to the term mineral interest owners royalties that were attributable to past production and thenceforth on subsequent production. The lease assignee then requested recoupment from the reversioners for royalties paid to the reversioners that, in light of Classen, should have been paid to the term mineral interest owners. The reversioners alerted the working interest owner that they intended to contest the continued existence of the term mineral interest, at which point the working interest owner suspended payment of all royalties attributable to that interest. The reversioners then brought this action for declaratory judgment. Id. at 400-02, 799 P.2d at 487-88.
160. Id. at 404, 799 P.2d at 489.
law in 1960 when its primary term expired, the interest clearly expired in 1972 by application of the Smith decision.\textsuperscript{161} To apply Classen retroactively in this case would therefore constitute, in the court’s view, a revival of a long-expired mineral interest, which the court felt would be inappropriate.\textsuperscript{162} As a result, the term interest remained expired under Smith and the reversioners remained entitled to the royalties.\textsuperscript{163}

The Kansas Supreme Court has taken a much different view toward leases, holding that a lease is indivisible on this issue and that on-unit off-lease production is sufficient to sustain the entire lease, including an off-unit portion of the lease.\textsuperscript{164} Before this can apply, however, there must be a valid and effective unitization agreement. In Akandas, Inc. v. Klippel,\textsuperscript{165} the Kansas Supreme Court considered whether a particular arrangement should be characterized as a unitization agreement.\textsuperscript{166} The court described the matter as “one of contract construction”\textsuperscript{167} to be determined primarily by an assessment of the intent of the parties.\textsuperscript{168} The agreement was expressly labeled a “Unitization Agreement,”\textsuperscript{169}

\textsuperscript{161} Id.
\textsuperscript{162} Id. The court did not explain why the retroactive application of Classen would be any less appropriate than the retroactive application of Smith.
\textsuperscript{163} The court also addressed the term owner’s argument that the reversioners were barred by the statute of limitations. The term owner argued that the reversioners’ claim accrued when the primary term expired, which occurred more than fifteen years prior to the filing of this action. They argued that the claim was therefore barred by Section 60-307 of the Kansas Statutes Annotated. Id., 799 P.2d at 489-90. The court rejected this argument for three reasons: (1) the reversioners’ cause of action accrued not when the primary term expired but when Smith was decided, because only then did the reversioners have a recognizable basis for claiming that the term interest had terminated; (2) the term owner did not act in the requisite adverse manner, but instead was “wholly passive”; and (3) a covenantee cannot acquire adverse possession against fellow covenantees “unless there is an ouster of which the covenantee has notice.” Id. at 405, 799 P.2d at 490 (citing Smith v. Home Royalty Ass’n, Inc., 209 Kan. 609, 498 P.2d 98 (1972)).
\textsuperscript{166} The court defined a “unitization agreement” as “[a]n agreement or plan of development and operation for the recovery of oil and gas made subject thereto as a single consolidated unit without regard to separate ownerships and for the allocation of costs and benefits on a basis as defined in the agreement or plan.” Id. at 465, 827 P.2d at 44 (quoting Williams & Meyers, supra note 2, at 1315).
\textsuperscript{167} 250 Kan. at 464, 827 P.2d at 44.
\textsuperscript{168} Id. at 464-65, 827 P.2d at 44.
\textsuperscript{169} Id., 827 P.2d at 45-46. The court stated that “[i]n ascertaining the parties’ intent whether the document is a unitization agreement, a joint management agreement, or a division order, the document’s title can be considered.” Id. at 467, 827 P.2d at 45.
made several references to unitization and unit operations, and declared that "the said Buffalo Field Unit is hereby unitized." The court rejected the lessors' claim that the agreement was a joint management or operating agreement or a division order. The court concluded that the agreement was a valid unitization agreement, with the consequence that all of the component leases were extended by production on the unit. Even though the

170. In one of the "whereas" clauses, the document recited that "the proposed unit operations are fair and equitable to all interest owners," that "unitization and the production methods to be utilized under such a plan of operation provide greater protection for the general health of the public and for the preservation of the environment," and that "the unitized management, operation and further development of the Buffalo Field Unit is economically feasible and reasonably necessary to prevent waste within the reservoir area and thereby increase substantially the ultimate recovery of oil and gas." Id. at 462-63, 827 P.2d at 42-43.

171. Id. at 463, 827 P.2d at 43.

172. Id. at 467, 827 P.2d at 46. The court described a "joint management or operating agreement" as:

An agreement between or among interested parties for the operation of a tract or leasehold for oil, gas and other minerals. Typically the agreement provides for the development of the premises by one of the parties for the joint account. The parties to the agreement share in the expenses of the operations and in the proceeds of development, but the agreement normally is not intended to affect the ownership of the minerals or the rights to produce, in which respects, among others, the joint operating agreement is to be distinguished from a unitization agreement and from a mining partnership.

Id. at 465-66, 827 P.2d at 45 (quoting Williams & Meyers, supra note 2, at 622-24).

173. Id. at 467, 827 P.2d at 46. The court defined a "division order" as "[a] contract of sale to the purchaser of oil or gas . . . [that] directs the purchaser to make payment for the value of the products taken in the proportions set out in the division order." Id. at 466, 827 P.2d at 45 (quoting Williams & Meyers, supra note 2, at 334). The court noted that this case did not involve an oil or gas purchaser, that production shares under the agreement were established without regard for the location of unit wells, that the agreement contained no provision changing the production allocation percentages in the event that a lease terminated, and that the agreement contained no provision allowing the leaseholder to withdraw from the agreement if production ceased on the leaseholder's land. Id. In all these respects, the agreement in question was unlike a typical division order.

174. Id. at 467, 827 P.2d at 46. None of the leases specifically authorized the respective lessee to unitize the leased premises. Id. at 460, 827 P.2d at 41. In the absence of specific authorization to pool or unitize, the lessee generally does not have the power to pool or unitize the lessor's interest. 4 Kuntz, supra note 29, § 48.3 (c)(1). This lack of specific authorization was no obstacle in Akandas, however, because the lessors were parties to the unitization agreement. 250 Kan. at 460, 827 P.2d at 41.

175. 250 Kan. at 475, 827 P.2d at 50. The lessors argued alternatively that they had the authority to terminate the unitization agreement at will because the agreement did not specify its duration. Id. The court cited the general rule that when two or more instruments are executed by the same parties contemporaneously or in the course of the same transaction, the instruments will be read and construed together. The court held that the unitization agreement therefore had the same termination date as the leases and was not terminable at the will of the lessors. Id. at 475-76, 827 P.2d at 51 (quoting West v. Prairie State Bank, 200 Kan. 263, 267, 436 P.2d 402, 405 (1968)).
agreement did not expressly provide that unit production would extend all the leases in the unit, the court held that such a provision is implied. The court cited the general rule that "absent an express agreement to the contrary, production within the unit will perpetuate the individual leases within the unit" and noted that to evaluate each component lease individually would be counter to the goal of efficient and economical development of the unit as a whole.

V. PROBLEMS PERTAINING TO GAS STORAGE

The rule of capture states that landowners are entitled to all the minerals produced from wells drilled on their own property, even if part of the production migrated from neighboring tracts. The rule of capture modifies the ad coelum doctrine and corresponds to the mobile nature of oil and gas. The rule encourages producers to engage in full activity and rewards their efforts by protecting them from potential liability for trespass or conversion when drainage occurs.

The rule of capture was borrowed from the law of wild animals. The rule of capture, as applied to wild animals, is qualified by the notion that a person’s rights to a captured animal are

176. Id. at 475, 827 P.2d at 50.
177. Id.; see 2 Bruce M. Kramer & Patrick H. Martin, The Law of Pooling and Unitization § 20.02[1]; Vitauts M. Gulbis, Annotation, Production on One Tract as Extending Term on Other Tract Where One Mineral Lease Conveys Oil or Gas Rights in Separate Tracts for as Long as Oil or Gas Is Produced, 35 A.L.R.4th 1167 (1985); see also Rogers v. Westhoma Oil Co., 291 F.2d 726, 729 (10th Cir. 1961) ("production from any part of a consolidated or pooled unit perpetuates all leases within the unit, even as to ununitized acreage, unless the leases provide to the contrary"); Klippel v. Beinar, 222 Kan. 681, 685, 567 P.2d 867, 871 (1977) ("The life of the lease is extended as to all included tracts beyond the primary term . . . as long as oil [or] gas [is] produced from any one of the tracts included."); Somers v. Harris Trust & Sav. Bank, 1 Kan. App. 2d 397, 400, 566 P.2d 775, 777 ("The majority rule elsewhere is that where a portion of an oil and gas lease is committed to a unit, production anywhere in the unit extends the term of the entire lease.").
178. 250 Kan. at 475, 827 P.2d at 50.
180. "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 Williams & Meyers, supra note 6, § 204.
181. See 1 Kuntz, supra note 29, § 4.1.
182. See generally id.
183. See People’s Gas Co. v. Tyner, 31 N.E. 59, 60 (Ind. 1892) (noting that oil and gas, like wild animals, have the power and tendency to escape from the possessor).
forfeited by the escape or release of the animal.\textsuperscript{184} Whether this should apply to a producer of gas who reinjects the gas for storage purposes is a question of some debate.\textsuperscript{185} Some courts have held that the producer loses its right to the produced gas by reinjecting the gas into the ground.\textsuperscript{186} Others hold that "the owner of gas does not lose title thereof by storing the same in a well-defined underground reservoir."\textsuperscript{187} In the pre-Survey case of \textit{Anderson v. Beech Aircraft Corp.},\textsuperscript{188} the Kansas Supreme Court aligned with \textit{Hammonds} and held that ownership rights are lost when gas is reinjected.\textsuperscript{189} The court expressly qualified its holding, however, by acknowledging the statutory right of natural gas public utilities to condemn underground storage facilities and to store gas in these facilities without forfeiting their ownership rights.\textsuperscript{190}

During the survey period, the Kansas Supreme Court again confronted this issue in \textit{Union Gas System, Inc. v. Carnahan}\textsuperscript{191} Union Gas, a natural gas public utility, stored gas in a particular underground reservoir, the precise boundaries of which were unknown. The DeTar farm apparently did not overlie the storage reservoir, but was located close enough so that as gas was injected into the storage reservoir, some gas, including some of the injected gas, migrated to the DeTar land. As a result, much of the gas produced by the DeTars' lessee was non-native gas that Union Gas had injected for storage purposes. Union Gas initiated statutory proceedings\textsuperscript{192} to condemn the DeTar subsurface for use as underground storage. Pursuant to these proceedings, the Kansas Corporation Commission issued a formal certificate finding that the underground formation was suitable for underground storage of

\begin{flushleft}
\textsuperscript{184} See Mullett v. Bradley, 53 N.Y.S. 781, 782 (Sup. Ct. 1898) (noting that the owner loses the property interest in an animal that returns to the wild, absent a custom of the animal to return to the owner); \textsc{Ray A. Brown, The Law of Personal Property} § 2.5 (Walter B. Raushenbush ed., 3d ed. 1975).

\textsuperscript{185} See generally \textsc{Kuntz, supra} note 29, § 2.6.

\textsuperscript{186} The leading case is \textit{Hammonds v. Central Kentucky Natural Gas Co.}, 75 S.W.2d 204 (Ky. 1934).


\textsuperscript{189} \textit{Id.} at 347-48, 699 P.2d at 1031-32; see \textit{DeLaTorre, supra} note 15, at 914-16.

\textsuperscript{190} 237 Kan. at 348, 699 P.2d at 1032. The court's holding was limited to a situation "where a natural gas public utility was not involved, where no certificate authorizing an underground storage facility had been issued by the Kansas Corporation Commission, and where the defendant had used the property of an adjoining landowner for gas storage without authorization or consent." \textit{Id.}

\textsuperscript{191} 245 Kan. 80, 774 P.2d 962 (1989).

\end{flushleft}
natural gas and that its use would be in the public interest. The trial court affirmed the Commission's action, held that Union Gas had the power of eminent domain as a natural gas public utility, and held that its proposed taking of the DeTar formation was necessary to its lawful purposes. The court appointed appraisers, who determined specific awards for the owners of various interests in the DeTar subsurface. Union Gas challenged certain aspects of these awards, the trial court rejected these challenges, and Union Gas appealed.

The Kansas Supreme Court recognized that a public utility's statutory right to condemn underground storage areas supersedes Anderson, but only to the extent that the public utility follows the statutory procedures. Because Union Gas neglected to pursue this procedure until January 13, 1986 (the date of the Commission's certificate), Anderson applied until that date and Union Gas was not entitled to recover for any of its gas produced by the DeTars prior to that date. Union Gas was entitled, however, to an offset from the DeTars' condemnation award for the net value of non-native gas produced by the DeTars after that date. The court also held that the legislature intended that the appraisal be based on the unit method of evaluation, which compares the fair market value of the property immediately before and after the taking, rather than on the "summation" method whereby the interests of the different parties are valued separately and added up to a final total.

194. 245 Kan. at 85, 774 P.2d at 966.
196. 245 Kan. at 85, 774 P.2d at 966. These consisted of awards to the working interest owners for lease development expenditures, the fee owners for condemnation compensation, and the owners of royalty, overriding royalty, and working interests for native gas. Id.
197. Id. at 86, 774 P.2d at 966-67.
198. Id. at 86-87, 774 P.2d at 967; see supra note 192.
199. 245 Kan. at 87, 774 P.2d at 967.
200. Id. at 88-89, 774 P.2d at 968. The court held that this date controlled on this issue, even though the date of taking for purposes of determining compensation was April 9, 1987 (the date on which Union Gas paid the condemnation award). Id. at 87-88, 774 P.2d at 968 (citing Kan. Stat. Ann. § 26-507).
201. Id. at 90, 774 P.2d at 969. The court also rejected Union Gas's argument that it had acquired adverse possession or an easement by prescription. Id. at 87, 774 P.2d at 967. Union Gas claimed that it had been occupying the DeTar area from 1967 to 1985, more than the fifteen years required under Section 60-503 of the Kansas Statutes Annotated. Id., 774 P.2d at 967. The court held that Union Gas's possession was not open because Union Gas had produced no injected gas from the surface of the DeTar property, nor was it exclusive because Union Gas shared occupancy of the subsurface with the DeTars' native gas. Id.
In *Reese Exploration, Inc. v. Williams Natural Gas Co.*, also decided during the survey period, Reese claimed that Williams should be held liable for permitting injected gas from its storage field to escape upward into the oil-producing zone beneath Reese’s oil operations, thereby preventing Reese from successfully water-flooding its leases. Williams had received by assignment gas storage rights under the same tract where Reese owned the oil lease rights. The parties conducted activities at different sand levels, but some of Williams’s gas migrated into zones below Reese’s level of production, causing significant problems for Reese’s secondary recovery program. Williams took no steps to pinpoint the location of the migration, even though it had been aware of the migration for over ten years.

Williams’s main defense was that it had the right to store gas at all levels above 1050 feet, including at the level where Reese was conducting secondary recovery operations, and it therefore should not be liable for the presence of gas at that level. The court pointed out, though, that Williams’s storage rights had been created expressly “subject to the terms and conditions of [Reese’s] oil and gas leases, storage leases and supplemental oil and gas agreements.” The supplemental leases and the documents conveying storage rights to Williams contained no provision to support Williams’s claim to storage rights at the level in question.

More importantly, the court held that Williams, through its prior activities, had designated a particular sand as its storage zone, thereby defining and circumscribing its rights, with no option to change its gas storage zone unilaterally to the detriment of other mineral interest owners. Because each party’s rights were created expressly subject to the other’s, their rights were “co-existing,” with neither superior to the other. The court concluded that the only reasonable accommodation of these co-existing rights would be to hold that Williams, through its actions, had selected a specific formation as the location of its storage zone and did not now have the right to change the location. The court analogized to

---

203. The problems resulted primarily from the unnaturally high pressure created by Williams’s storage of gas. This high pressure hampered the flow of oil production and presented serious safety hazards. 768 F. Supp. at 1419-20.
204. Id. at 1424.
205. Id. at 1423.
206. Id. at 1423-24. Williams injected and withdrew gas solely and exclusively through the Bartlesville sand. All of the Williams wells were completed in the Bartlesville formation.
207. Id. at 1423.
208. Id. at 1424.
a situation in which a party acquires a general easement and then engages in actions that effectively define the specific scope and location of the easement. The general rule in that case is that "once the location of an easement has been finally established, whether by express terms of the grant or by use and acquiescence, it cannot be substantially changed without the consent of both parties." The court concluded that Williams's storage rights were limited to the particular level that it had been using. Williams was therefore liable for the harm caused when its gas escaped from that level.

The court also found Williams liable for negligence, holding that Williams owed Reese a duty of care in light of Williams's awareness that oil production was being conducted in the area, its knowledge that its gas storage activities were causing serious harm to Reese's waterflooding operations, its awareness that its gas was escaping, its lack of efforts to determine the location of the "pressure communication," and its failure to employ an effective mechanism to control the gas. However, the court rejected Reese's request for injunctive relief that would have required Williams to lower its storage field pressure. To issue such an injunction would have contravened the Federal Energy Regulatory Commission's authority to regulate storage rights. The court also rejected Reese's claim, based on Anderson, that it owned the migrated Williams gas. The court held that Anderson did not apply to a case in which the migration of gas was vertical, rather than horizontal. The court failed to provide a satisfactory rationale for this distinction. This distinction would seem invalid in a system that recognizes horizontal, as well as vertical, severance of rights.

VI. STANDARDS IN ASSESSING THE VALIDITY OF KANSAS CORPORATION COMMISSION ORDERS AND REGULATIONS

At issue in Southwest Kansas Royalty Owners Ass'n v. Kansas Corp. Commission was the validity of a Kansas Corporation

210. 768 F. Supp. at 1424 (quoting Youngstown Steel Prods. Co. v. Los Angeles, 240 P.2d 977, 979 (Cal. 1952)).
211. Id. at 1424.
212. Id.
213. Id. at 1425.
214. Id. at 1426.
215. Id.
216. Id. at 1427.
Commission amendment to the basic proration order\textsuperscript{218} for the Kansas Hugoton Gas Field to allow infill drilling.\textsuperscript{219} The amendment was prompted by evidence that large volumes of gas were trapped or slow-draining, were not being efficiently drained by existing wells, and would be wasted without an infill drilling program.\textsuperscript{220} The Kansas Supreme Court held that the Commission had subject matter jurisdiction to issue the amendment.\textsuperscript{221} The court concluded that the Commission's action was supported by sufficient competent evidence and was consistent with the Commission's statutory mandates to prevent waste and to protect correlative rights.\textsuperscript{222}

The court held that federal regulation did not preempt the Commission's actions.\textsuperscript{223} Under the Natural Gas Act,\textsuperscript{224} transportation and sale of natural gas in interstate commerce are within the exclusive domain of federal regulation.\textsuperscript{225} State regulation "cannot effect price increases for the state's production under the guise

\textsuperscript{218} A basic proration order is a "regulatory order establishing well spacing in a common source of supply and a formula for proration of gas production." Williams & Meyers, supra note 2, at 96.

\textsuperscript{219} Infill drilling is the "[D]rilling of an additional well or additional wells in excess of those provided for by a spacing order in order to more adequately drain a reservoir." Williams & Meyers, supra note 2, at 597.

\textsuperscript{220} 244 Kan. at 161, 769 P.2d at 6. The fundamental purpose of a basic proration order is to ensure that each owner will recover, without waste, that amount of gas underlying his or her land. A basic proration order can be amended as new information comes to light. The Commission had allowed only one well per basic proration unit in the Hugoton Field because one well was sufficient to drain the unit. But new evidence indicated that one well was no longer sufficient because pressures were declining to the point where some gas would never be recovered if not produced soon. Id.

\textsuperscript{221} Id. at 171, 769 P.2d at 12. Section 55-703 of the Kansas Statutes Annotated authorizes the Commission to regulate the production of natural gas "from any and all common sources of supply." Kan. Stat. Ann. § 55-703 (1988). One of the questions in Southwest Kansas Royalty Owners was whether the Commission's amendment applied to a "common source of supply." The opponents to the amendment argued that it applied to zones with "permeability barriers so complete that they completely stop the movement of gas into other areas deemed part of the common source." 244 Kan. at 169, 769 P.2d at 12. The court rejected this argument and held that the amendment applied to a common source of supply. Id. at 170, 171, 769 P.2d at 11, 12. The court stated that although flow between the various pools within the field may be restricted in the short term, they were not separate reservoirs in the long term. None of the pools was completely trapped. They were "part of the same geological series of gas that moved into the area at one time and, over geological time, the gas would move as part of the same reservoir system." Id. at 170, 769 P.2d at 12. The court pointed to evidence that "over geological time, one well could theoretically drain the entire field." Id.

\textsuperscript{222} Id. at 186, 188, 769 P.2d at 21, 22.

\textsuperscript{223} Id. at 181, 769 P.2d at 18.


\textsuperscript{225} 244 Kan. at 175-76, 769 P.2d at 15.
of conservation measures.” However, Congress has carefully limited the scope of federal regulation to allow the states to regulate production and gathering of natural gas. The Natural Gas Act expressly limits federal authority so as not to apply to “the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.” The prime concern of the Commission’s amendment was the rate of production and the efficient gathering of natural gas sold in interstate commerce, rather than the price at which the gas was sold. The amendment was directed not to buyers, but to landowners and producers. The court acknowledged that the amendment may incidentally affect the price of gas sold in interstate commerce and the resulting profits, but this was not sufficient grounds to hold the amendment invalid. In any event, the actual price of gas remained a matter of free negotiation between the buyer and the producer based on market demand. The amendment did not require a purchaser to buy greater quantities of gas or to buy from any particular well or gas field.

In view of the flexibility permitted in locating the infill wells, the opponents to the amendment argued that it affirmatively threatened their correlative rights by allowing the possibility of “corner-shooting” the wells. The court agreed that the evidence was insufficient to support the Commission’s finding that infill drilling would protect correlative rights. The court nevertheless held the amendment valid on the grounds that it prevented waste, which the court described as the “Commission’s foremost function” and a sufficient basis for the Commission’s authority to regulate. The court also thought it appropriate for the Com-

226. Id. at 176, 769 P.2d at 15 (citing Transcontinental Pipe Line Corp. v. State Oil & Gas Bd., 474 U.S. 409 (1986)).
227. Id. at 177, 769 P.2d at 16 (citing Colorado Interstate Co. v. Federal Power Comm’n, 324 U.S. 581, 598 (1945); Colorado-Wyoming Gas Co. v. Federal Power Comm’n, 324 U.S. 626, 630 (1945)).
229. 244 Kan. at 181, 769 P.2d at 18.
230. Id. at 183, 769 P.2d at 20.
231. Id. at 184, 769 P.2d at 20.
232. Id. at 187-88, 769 P.2d at 22. The recovery of slow-draining gas was within the Commission’s charge of preventing waste. Id. “Findings of irretrievable loss with delayed drilling aside, the record provides evidence for the Commission’s finding that gas not recoverable within 50 years is not economically valuable.” Id. at 187, 769 P.2d at 22.
234. Id. Section 55-603 of the Kansas Statutes Annotated authorizes regulation “under
mission to consider the public need for long-term reserves that would be generated by the infill drilling. 235

In *Northwest Central Pipeline Corp. v. State Corp. Commission of Kansas*, 236 the United States Supreme Court considered whether a particular regulation issued by the Kansas Corporation Commission violated the Commerce Clause of the United States Constitution 237 or was preempted by the Natural Gas Act. 238 The regulation permanently canceled producers' underages 239 that were not produced within eight years after accrual. This represented a change from an arrangement whereby the producer was allowed to produce accumulated underages at any time. The problem that prompted the change was that interstate pipelines, relying on the unlimited time within which to produce underages, were reducing their purchases of gas from Hugoton producers. 240 Meanwhile, certain Kansas-Hugoton producers with intrastate buyers continued to produce and to sell. The result was an imbalance between underproduced wells supplying interstate pipelines and overproduced wells supplying the intrastate market. 241 This imbalance

conditions (a) constituting waste as herein defined, or (b) independently of waste, under conditions injurious to the respective correlative rights of the producers therein." KAN. STAT. ANN. § 55-603 (1983 & Supp. 1992) (emphasis added). The court referred to *Aylward Production Corp. v. Kansas Corp. Comm'n*, 162 Kan. 428, 176 P.2d 861 (1947), which held that "the Commission had the authority to amend its rules upon its finding such amendment was necessary to prevent waste or injury to correlative rights." 244 Kan. at 184, 769 P.2d at 20.

235. 244 Kan. at 188-90, 769 P.2d at 23-24.
237. U.S. CONST. art. I, § 8, cl. 3.
239. An underage is "[t]he amount of allowable production from a well in excess of actual production therefrom." WILLIAMS & MEYERS, supra note 2, at 1308. The allowable production (commonly referred to as the "allowable") is the amount of oil or gas that a well is permitted to produce under proration orders of a state regulatory commission. Id. at 44.

240. Much of the gas produced from the Hugoton Field is dedicated by long-term contract to five interstate pipelines. These interstate pipelines generally entered into their current contracts to purchase Hugoton gas at a time when the market was underdeveloped, usually establishing relatively low prices. The gas market later changed, however, when "an acute shortage of natural gas during the 1970's" prompted Congress to enact the Natural Gas Policy Act of 1978, which provided for market-driven wellhead pricing for newly produced gas. 15 U.S.C. §§ 3301-3432. In response, many pipelines wishing to take advantage of this committed themselves to long-term take-or-pay contracts at high prices. When the market dwindled in the early 1980s, interstate pipelines reduced their takes under contracts with Hugoton producers primarily because these contracts did not contain take-or-pay penalties. This practice was facilitated by paragraph (p) of the Hugoton Basic Proration Order, which permitted stored Hugoton gas to be produced at any time. 489 U.S. at 501-02.

241. 489 U.S. at 502-03.
resulted in drainage, thereby threatening producers’ correlative rights in the pool.\textsuperscript{242} The regulation provided for cancellation of underages in an effort to encourage more production and to restore balance to the field.\textsuperscript{243} Opponents of the regulation argued, however, that it was preempted by the Natural Gas Act, which gives the Federal Energy Regulatory Commission exclusive jurisdiction over the transportation and sale for resale of gas in interstate commerce. The Kansas Supreme Court held that the regulation was not preempted.\textsuperscript{244} The United States Supreme Court affirmed.\textsuperscript{245}

The United States Supreme Court held that the regulation did not encroach upon a field that Congress had preempted, but regulated a field that Congress expressly left to the states.\textsuperscript{246} Section 1(b) of the Natural Gas Act gives the Federal Energy Regulatory Commission exclusive jurisdiction over interstate transportation and sales, but expressly reserves to the states the power to regulate “production or gathering of natural gas.”\textsuperscript{247} Thus, Congress intended to leave the states with the power to regulate production as a means of preventing waste and protecting correlative rights.\textsuperscript{248} The regulation in question was sufficiently related to these purposes.\textsuperscript{249} It would be inconsistent for Congress to assign these purposes to the states and then to withhold from the states the means to achieve them.\textsuperscript{250}

In reaching its decision, the Court distinguished two prior cases—Northern Natural Gas Co. v. State Corp. Commission of Kansas\textsuperscript{251} and Transcontinental Pipe Line Corp. v. State Oil & Gas Board of Mississippi.\textsuperscript{252} Both cases held that state regulations requiring gas purchasers to take gas ratably from producers were preempted by federal statutory regulation of interstate transportation and sales. The Court distinguished those cases on the grounds that the

\textsuperscript{242} Id. at 502-04.
\textsuperscript{243} Id. at 503.
\textsuperscript{244} Id. at 509.
\textsuperscript{245} Id.
\textsuperscript{246} Id.
\textsuperscript{248} 489 U.S. at 511. “The terms ‘production and gathering’ in § 1(b) are sufficient in themselves to reserve to the States not merely ‘control over the drilling and spacing of wells and the like,’ Colorado Interstate Gas Co. v. FPC, 324 U.S. 581, 603 (1945), but also the power to regulate rates of production over time—a key element, after all, in efforts to prevent waste and protect correlative rights.” Id.
\textsuperscript{249} Id. at 512.
\textsuperscript{250} Id. at 512-13.
\textsuperscript{251} 372 U.S. 84 (1963).
\textsuperscript{252} 474 U.S. 409 (1986).
state regulations in *Northern Natural* and *Transcontinental* imposed purchasing requirements on interstate pipelines,\(^{253}\) whereas the regulation in this case regulated production rates in order to protect producers' correlative rights, a matter clearly within the jurisdiction of the states.\(^{254}\) The regulation in question neither conflicted with the federal scheme of regulating interstate purchasers' costs nor imposed any direct purchasing requirements on pipelines.\(^{255}\) The regulation simply defined the producer's right to extract gas and therefore was consistent with the states' rights to protect producers' correlative rights.\(^{256}\) The regulation may have an incidental effect on gas purchasers' costs, but this is an insufficient basis to invalidate a regulation; otherwise, every regulation of production would be invalid as having some impact on purchasers' costs.\(^{257}\)

Likewise, the Court held that the regulation did not violate the Commerce Clause.\(^{258}\) The regulation was neutral on its face, providing for the cancellation of underages whether they supplied the intrastate or interstate markets.\(^{259}\) The regulation, which was "aimed at producers and require[d] nothing of purchasers,"\(^{260}\) may affect interstate buyers, but any impact on interstate commerce would be incidental to the state's efforts to prevent waste and to protect correlative rights, which are appropriate concerns of the states under the Natural Gas Act.\(^{261}\) Incidental impact on interstate commerce is an insufficient basis to invalidate a regulation; otherwise, every regulation of production could be held invalid on this basis.\(^{262}\)

---

253. 489 U.S. at 513. The court described the ratable take regulation in *Northern Natural* as """unmistakably and unambiguously directed at purchasers."""* Id.* (quoting *Northern Natural*, 372 U.S. at 92).

254. *Id.* at 514.

255. *Id.* at 516-17.

256. *Id.* at 517-19.

257. *Id.* at 514.

258. *Id.* at 526.

259. *Id.*

260. *Id.* at 524.

261. *Id.* at 523 (citing Natural Gas Act, § 1(b), 15 U.S.C. § 717(b) (1988)).

262. *Id.* at 524.