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CASE NOTE

OIL AND GAS—Defining the Point of Sale for Gas Under an Oil and Gas Lease Containing Both Market Value and Amount Realized Royalty Provisions. *State v. Davis*, 728 P.2d 1107 (Wyo. 1986).

The State of Wyoming owns certain oil and gas interests in Converse County, Wyoming. Davis Oil Company (hereinafter Davis) leases this interest. Davis owns and operates two producing wells on the lease, Concamp State No. 1 and No. 2.¹ Each of these wells produces casinghead gas² and oil. Davis transports the casinghead gas in its pipeline to a separator located on the lease premises.³ The separator removes water and other impurities from the casinghead gas to help facilitate transportation.⁴

The gas leaves the separator and enters a pipeline owned by Phillips Petroleum Company (hereinafter Phillips).⁵ Shortly after the gas enters the pipeline, but before it leaves the lease premises, Phillips meters and tests the gas.⁶ This testing determines the quantity and quality of the raw casinghead gas as it enters Phillips' gathering system.⁷ Phillips transports this gas to a main transmission line and commingles it with gas from other wells in the Powder River Basin.⁸ Phillips then transports the gas to its processing plant in Douglas, Wyoming.⁹ At the plant Phillips processes the gas into residue gas and natural gas liquids. Phillips sells the residue gas to Panhandle Eastern Pipeline Company under a long-term sales contract, and sells the natural gas liquids to Phillips' refinery in Borger, Texas.¹⁰ At the plant tailgate, Phillips meters both the residue gas and natural gas liquids for quantity and quality.¹¹

Not all of the gas produced from the two Concamp wells makes it to the plant tailgate. The main transmission line uses gas booster stations to transport the gas to Phillips' plant. These booster stations are fueled by gas from the pipeline.¹² Phillips fuels its plant with gas taken from the

1. *State v. Davis*, 728 P.2d 1107, 1108 (Wyo. 1986).

2. Casinghead gas is gas produced in conjunction with liquid hydrocarbons and other products. *Id.* at 1108.

3. *Id.*

4. *Id.*

5. Brief for Appellant at 3, *State v. Davis*, 728 P.2d 1107 (Wyo. 1986) (No. 86-71) [hereinafter Brief for Appellant].

6. *Id.*

7. *Id.* at 22.

8. Brief for Appellee at 6, *State v. Davis*, 728 P.2d 1107 (Wyo. 1986) (No. 86-71) [hereinafter Brief for Appellee].

9. *Id.*

10. Brief for Appellant, *supra* note 5, Appendix A at 3.

11. *Id.* at 2. The plant tailgate refers to the discharge side of Phillips' plant where processed gas is delivered to the purchaser of the processed gas.

12. Brief for Appellee, *supra* note 8, at 6. Gas booster stations are compressors that maintain enough pressure in the pipeline system to move the gas to Phillips' plant.

gas stream in the plant,¹³ and sometimes vents gas from both the gathering system and the plant directly into the atmosphere.¹⁴

In order to sell the casinghead gas from the two Concamp wells, Davis entered into two gas sales contracts with Phillips.¹⁵ The contracts provide that title and control pass to Phillips upon delivery of the gas to Phillips' facilities.¹⁶ Davis receives a percentage of Phillips' proceeds from the subsequent sale of the processed products.¹⁷ These prices are then multiplied by the applicable percentage amount of tailgate products attributable to the Concamp wells to determine the amount Phillips owes Davis.¹⁸ Phillips uses this figure to determine the royalty due the state and deducts the royalty from the amount paid to Davis.¹⁹

The lease entitles the State of Wyoming, as lessor, royalties on gas produced from the Concamp wells. The State drafted the lease, and since 1960, all state oil and gas leases have contained the following royalty provision:

(d) ROYALTIES. The royalties to be paid by lessee are:

. . . .

(ii) on gas, including casinghead gas or other hydrocarbon substance, produced from said land saved and *sold or used off the premises* or in the manufacture of gasoline or other products therefrom, the *market value at the well* of one-eighth of the gas so sold or used, provided that on gas *sold at the wells* the royalty shall be one-eighth of the *amount realized* from such sale. (emphasis added)²⁰.

Davis had been paying the State one-eighth of the amount it received, i.e. amount realized, from the sale of gas to Phillips.²¹ The State notified Davis that it believed the royalty payments were inadequate. Davis then sought a declaratory judgment in district court that the royalty payments had been properly made. The district court determined that for royalty purposes the gas had been "sold or used off the premises" and that the lease required Davis to pay royalties based on the market value.²²

On appeal, the Wyoming Supreme Court addressed the issue of where the sale of gas for royalty purposes occurred.²³ If the sale occurs off the

13. *Id.* at 8.

14. *Id.* at 8-9. Phillips does not include any of the gas used for these purposes in the calculation determining the amount of residue gas and natural gas liquids at the plant tailgate attributable to the Concamp wells. *Id.*

15. Brief for Appellant, *supra* note 5, at 3. For a complete understanding of the gas sales contracts, see Brief for Appellant, Appendix B, which sets forth one of the Casinghead Gas Contracts between Davis and Phillips. *Id.*

16. *Id.* at Appendix B at 1.

17. *Davis*, 728 P.2d at 1108.

18. Brief for Appellant, *supra* note 5, Appendix A at 1-5. For a complete discussion of the pricing formula, see Appendix A. *Id.*

19. *Davis*, 728 P.2d at 1108.

20. Brief for Appellant, *supra* note 5, at 5.

21. *Id.* at 4.

22. *Davis*, 728 P.2d at 1108.

23. *Id.* at 1109.

premises, royalties are based on market value, and if the sale occurs at the well, royalties are based on the amount realized. The court affirmed the district court's decision and held that the sale occurred off the premises.²⁴ The following discussion centers around determining the elements that define a sale of gas. The passage of title, possession, control and the pricing function will be discussed as they relate to defining whether the sale of gas occurred on or off the premises. This casenote examines what constitutes a sale of gas for royalty purposes. Since this was a case of first impression in Wyoming, a review of other courts' decisions on this question is insightful.

BACKGROUND

Federal

The case of *Piney Woods Country Life School v. Shell Oil Company*,²⁵ involved a situation where Shell, as lessee of the mineral interests, also transported and processed the gas in its own facilities.²⁶ Shell sold the processed gas to Miscoa and Mississippi Power and Light under two gas sales contracts.²⁷ Both contracts provided that title to the gas passed in the field, but the buyers under the contracts did not take delivery and control of the gas until it had been processed and redelivered.²⁸

Apparently the parties to the contracts agreed that title to the gas would pass in the field to avoid state regulation.²⁹ The contracts provided that the sale price included a substantial consideration for transportation and processing services provided by Shell. Under the contracts, measurements of the quantity and quality of the gas used for determining the amount owed by Miscoa were to be made after Shell processed the gas.³⁰ Shell had been paying royalties based on the actual revenues received from the sale of processed gas and sulfur under the two contracts, and Shell had been deducting a substantial portion of the processing costs from the royalties paid.³¹

The leases in question contained royalty provisions similar in all relevant parts to the State of Wyoming leases.³² The lessors sued Shell seeking to have the royalties paid on market value, not the amount realized from the sale by Shell. The trial court determined that since title to the gas passed in the field, i.e. at the well, the royalties were to be paid on the amount realized from the sales by Shell.³³ The court of appeals re-

24. *Id.* at 1110.

25. 726 F.2d 225 (5th Cir. 1984).

26. *Id.* at 229.

27. *Id.*

28. *Id.*

29. *Id.*

30. *Id.*

31. *Id.*

32. *Id.* at 228. The royalty provision provides that royalties "on gas . . . sold or used off the premises . . . [will be based on] the market value; . . . [for] gas sold at the wells . . . [it will be the] amount realized." *Id.*

33. *Id.* at 229.

versed, holding that even though the sales contracts provided that title passed in the fields, "the gas sold by Shell was not 'sold at the well,' within the meaning of the lease."³⁴

Applying Mississippi's Uniform Commercial Code sections 75-2-107(1) (U.C.C. § 2-107), 75-2-401(1) (U.C.C. § 2-401), 75-2-105(4) (U.C.C. § 2-105) and 75-2-501(1) (U.C.C. § 2-501)³⁵ to the gas sales contract, the court determined that title passed at the well. Using the following analysis, the court determined that the "simple passage of title does not control whether the gas was 'sold at the well' within the meaning of the leases."³⁶ The court found that "at the well" describes both location and quality³⁷ and that the sale of gas occurs at the well only if its value has not increased before the sale.³⁸ With this in mind, the court of appeals held "that 'at the well' refers to gas in its natural state, before the gas has been processed or transported from the well."³⁹ Therefore, under the leases in question, the sale of gas did not occur at the well and a market value royalty⁴⁰ was appropriate.⁴¹ Two state supreme courts have also addressed the question of where the sale of gas for royalty purposes occurs. These decisions focus on where delivery, control and title of the gas pass to the buyer in determining where the sale occurred.

State Court Decisions

In *Exxon Corp. v. Middleton*,⁴² the royalty clause⁴³ in question contained provisions identical in all relevant parts to the State of Wyoming lease. Exxon owned the leases, and some of the natural gas from these leases was processed in Exxon's plant located in the Anahuac Field.⁴⁴ Exxon delivered the processed gas at the plant tailgate to three purchasers.⁴⁵ Exxon contended that even though the sale occurred off the lease premises, but within the Anahuac Field where the leases were located, the sale occurred at the well.⁴⁶

34. *Id.* at 231.

35. MISS. CODE ANN. § 75-2-107(1) (1972); MISS. CODE ANN. § 75-2-401(1) (1972); MISS. CODE ANN. § 75-2-105(4) (1972); MISS. CODE ANN. § 75-2-501(1) (1972).

36. *Piney Woods*, 726 F.2d at 232.

37. *Id.* at 231. The court stated that "[m]arket value at the well means market value before processing and transportation, and gas is sold at the well if the price paid is consideration for the gas as produced but not for processing and transportation." *Id.*

38. *Id.* at 232.

39. *Id.* at 242.

40. As discussed by the *Piney Woods* court, as long as the price escalation clause in the contract kept up with the actual market price of gas there would be little difference in royalties using market value or amount realized. It is only when the price of gas begins to rise much faster than the escalation clause that the lessor desires royalties based on market value. *Id.* at 233.

41. *Id.* at 242. For a discussion of cases interpreting royalty provisions in general and *Piney Woods* in particular, see Harris, *Gas Royalties-Leading State and Federal Cases Reviewed: Alice's Adventures in "Royalty-Land,"* 37 OKLA. L. REV. 699 (1984).

42. 613 S.W.2d 240 (Tex. 1981).

43. *Id.* at 241. The royalty provision provides that royalties "on gas . . . sold or used off the premises . . . [will be based on] the market value; . . . [for] gas sold at the wells . . . [it will be the] amount realized." *Id.*

44. *Id.* at 242.

45. *Id.*

46. *Id.*

The Texas Supreme Court held that " 'off the premises' modifies both 'sold' and 'used' " and that " 'premises' is the land described in the lease agreement."⁴⁷ The court then proceeded to determine which market value was appropriate for calculating royalties. Exxon argued that market value meant the market value when the gas sales contract became effective. The court held that market value meant the market value when Exxon delivered the gas to the buyer. The court determined the gas could not be sold until it was produced and held that the gas was " 'sold' when delivered by Exxon to its customers."⁴⁸

In *Matzen v. Cities Service Oil Co.*,⁴⁹ Ashland Oil Company, as lessee, maintained and operated a gathering system for leases it produced in the Hugoton Field.⁵⁰ Ashland and Cities Service Pipeline had entered into a contract for the purchase of gas produced from the leases.⁵¹ In order to fulfill its obligation under the contract, Ashland transported the gas to a central delivery point away from the wells where it transferred possession of the gas to Cities Service Pipeline.⁵² The royalty provisions in these leases were in all relevant parts the same as the State of Wyoming lease.⁵³

Ashland contended that the sale of gas occurred at the well and it had paid royalties based upon the proceeds of the gas purchase contract.⁵⁴ The Kansas Supreme Court affirmed the trial court's holding that the sale occurred off the premises, and therefore, royalties should be based on market value. The court found that "substantial competent evidence"⁵⁵ supported the holding. Thus, the point of sale was determined by the point of delivery of the gas to the purchaser.

In *Waechter v. Amoco Production Company*,⁵⁶ Amoco, as lessee, sold wet casinghead gas to Cities Service Gas Company. Amoco delivered title and control of the gas to Cities Service Gas Company at the wellhead where the gas entered Cities' pipeline.⁵⁷ Under the gas purchase contract, Amoco reserved the right to extract gasoline and other liquid hydrocarbons from the gas. The price Amoco was to receive for the gas was set forth in the contract.⁵⁸ The Kansas Supreme Court reasoned that since the lessee delivered title and possession to the gas at the well, the sale

47. *Id.* at 243.

48. *Id.* at 245.

49. 233 Kan. 846, 667 P.2d 337 (1983).

50. *Id.* 667 P.2d at 340. The leases in question were located within the Hugoton Field. The field's boundaries approximate the boundaries of the underground gas reserves. *Id.*

51. *Id.* at 348.

52. *Id.*

53. *Id.* The royalty provision provides that royalties "on gas . . . sold or used off the premises . . . [will be based on] the market value; . . . [for] gas sold at the wells . . . [it will be the] amount realized." *Id.*

54. *Id.*

55. *Id.*

56. 217 Kan. 489, 537 P.2d 228 (1975), *adhered to after reh'g*, 219 Kan. 41, 546 P.2d 1320 (1976).

57. *Waechter*, 537 P.2d at 247.

58. *Id.*

occurred at the well.⁵⁹ The lessee retained a right to process the gas,⁶⁰ but the sale occurred at the well and Amoco owed royalties on the amount realized from the sale.⁶¹

Wyoming Statutes

Since, under the law of sales, Wyoming defines a sale of minerals as a sale of goods,⁶² a discussion of the pertinent sections of Wyoming's Uniform Commercial Code is appropriate. The Wyoming statutes define a sale as "the passing of title from the seller to the buyer for a price."⁶³ Section 34-21-246 of the Wyoming statutes discusses the passage of title, and states that title can pass in any manner explicitly agreed to by the parties.⁶⁴ The final statute necessary for a complete understanding of a sale of goods deals with an open price term. This statute states that "[t]he parties if they so intend can conclude a contract for sale even though the price is not settled."⁶⁵

THE PRINCIPAL CASE

This was a case of first impression in Wyoming. The court had to determine where a sale of gas for royalty purposes occurs. Thus, the court faced the task of analyzing courts' holdings from other jurisdictions and applying the Wyoming statutes on the sale of goods. The court held that since "Davis is paid for processed gas in Douglas, not casinghead gas at the wells, . . . market value, not the amount realized, is the proper standard for calculating royalties due the State."⁶⁶ Thus, the sale occurred off the premises and the market value royalty was appropriate.

The royalty provision provides that on gas sold at the wells royalties will be calculated on the amount realized from the sale.⁶⁷ Davis argued that since the gas sales contracts provided that title passed at the well, the sale occurred at the well.⁶⁸ The court agreed that title to the gas passed from Davis to Phillips at the separator but stated that "the passage of

59. *Id.* at 248.

60. *Id.*

61. *Id.*

62. WYO. STAT. § 34-21-207(a) (1977) reads: "A contract for the sale of timber, minerals or the like or a structure or its materials to be removed from realty is a contract for the sale of goods within this article if they are to be severed by the seller. . . ."; see U.C.C. § 2-107(1) (1978).

63. WYO. STAT. § 34-21-206(a) (1977); see U.C.C. § 2-106(1) (1978).

64. WYO. STAT. § 34-21-246(a) (1977) reads in part:

(i) . . . [T]itle to goods passes from the seller to the buyer in any manner and on any conditions explicitly agreed on by the parties;

(ii) Unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods,

See U.C.C. § 2-401(1),(2) (1978).

65. WYO. STAT. § 34-21-222(a) (1977); see U.C.C. § 2-305(1) (1978).

66. *Davis*, 728 P.2d at 1110.

67. *Id.* at 1108.

68. *Id.* at 1109. See Brief for Appellant, *supra* note 5, Appendix B at 1, for the clause dealing with delivery and passage of title.

title does not determine whether gas is sold 'at the wells' nor does it trigger the amount-realized provision."⁶⁹ The court then proceeded to analyze the reasoning of the decision in *Piney Woods*.⁷⁰

Determining that the *Piney Woods* court focused on the quality and location of the gas when it was sold,⁷¹ the court applied this reasoning to the facts in *State v. Davis*. Analyzing *Piney Woods*,⁷² the Wyoming Supreme Court determined that the Fifth Circuit Court of Appeals held that the lessee must pay royalties based upon market value because the lessee was paid for processed gas off the lease premises.⁷³ Focusing on where Phillips determined the contract price, the Wyoming Supreme Court found that since the price paid to Davis depended on Phillips' sale price after processing, the sale occurred off the premises.⁷⁴ Since Davis received a percentage of the proceeds from the sale of processed gas, not raw gas as it emerged from the well, the court determined the sale occurred off the premises and the market value royalty provision applied.⁷⁵

In this case, Davis delivered all its right, title and interest in the raw gas to Phillips upon its delivery into Phillips' pipeline.⁷⁶ This delivery took place on the lease premises before any transportation or processing of the raw gas.⁷⁷ The State argued that since the price Davis received depended on the price Phillips received upon its resale of the processed products, the sale occurred off the premises.⁷⁸ Thus, the market value royalty provision was appropriate. The Wyoming Supreme Court accepted this argument and focused its inquiry on where Phillips determined the contract price, not on where delivery of title and control occurred.⁷⁹ By focusing on where Phillips determined the contract price, which occurred off the premises when Phillips delivered processed gas to its purchaser, the court determined the sale occurred off the premises.

Dissent

Unable to accept the majority's reasoning, both Justice Urbigkit and Justice Cardine dissented.⁸⁰ The dissent focused its analysis on "whether the gas was 'sold at the wells' pursuant to the lease terminology."⁸¹ The dissent rejected *Piney Woods* as controlling since the only similarity with this case involved the pricing function which occurred after processing.⁸²

69. *Davis*, 728 P.2d at 1109.

70. *Id.* at 1109-10.

71. *Id.* at 1110.

72. *Id.* at 1109.

73. *Id.* at 1110.

74. *Id.*

75. *Id.*

76. *Id.* at 1111 (Urbigkit, J., dissenting) (Justice Cardine joined in Justice Urbigkit's dissenting opinion) (Concurring in part and dissenting on the issue involving interpretation of the lease royalty provision).

77. *Id.*

78. Brief for Appellee, *supra* note 8, at 13-14.

79. *Davis*, 728 P.2d at 1110.

80. *Id.* at 1111 (Urbigkit, J., dissenting).

81. *Id.*

82. *Id.* at 1113.

The dissent instead discussed the interpretation of state contracts and the application of the Wyoming Statutes on sales.

The State of Wyoming wrote the lease in question and did not allow bilateral negotiation of any provision in the lease. Davis thus faced a "take it or leave it" lease form if it wanted to do business with the State.⁸³ Determining that the same principles of construction and interpretation apply in this case as apply in any normal bilateral contract, the dissent argued that the Wyoming Statutes on the sale of goods should apply.⁸⁴

Applying sections 34-21-206 (U.C.C. § 2-106), 34-21-222 (U.C.C. § 2-305) and 34-21-246 (U.C.C. § 2-401) of the Wyoming Statutes,⁸⁵ the dissent argued that a present sale with an open price term occurred when the lessee transferred title and possession of the gas to Phillips at the well. The dissent reasoned that since title passed, possession transferred, and the buyer assumed responsibility on the lease premises, the subsequent pricing function had no bearing on the point of sale.⁸⁶ The dissent concluded its analysis by stating that the majority erred in focusing its analysis on the pricing function and not on the totality of the factors involved in the sales transaction.⁸⁷

ANALYSIS

Defining the Sale of Gas

In deciding the issue of where the sale of gas for royalty purposes occurs, the Wyoming Supreme Court purported to base its holding exclusively on the case of *Piney Woods*.⁸⁸ In doing so, it misinterpreted the Fifth Circuit Court of Appeals' holding in that case and focused instead on where Phillips determined the contract price.⁸⁹

By focusing on where Phillips determined the contract price and not on where delivery took place, the court misapplied the holding in *Piney Woods*. In *Piney Woods*, the lessee transferred title at the well to avoid state regulation, but the lessee retained control and possession of the gas until after it was processed.⁹⁰ Therefore, the court of appeals looked beyond the mere passage of title to where the purchaser determined the contract price to define the point of sale. The *Davis* fact situation can be distinguished, since Davis, as lessee, delivered title, control, and possession to the purchaser on the lease premises and did not retain any incidents of ownership once the gas entered Phillips' gathering system. The court's application of *Piney Woods* shifts the inquiry from where Davis delivered title, possession and control of the gas to Phillips to where Phillips calculated the amount it owed Davis for the raw gas. The resale of the processed gas thus became the point of sale for royalty purposes even

83. *Id.* at 1114.

84. *Id.* at 1115.

85. *Id.* at 1116.

86. *Id.* at 1117.

87. *Id.* at 1118.

88. *Id.* at 1110.

89. *Id.*

90. *Piney Woods*, 726 F.2d at 229.

though Davis relinquished all its interest in the gas upon delivery to Phillips.⁹¹ Although Davis relinquished its interest in the gas, it did retain a contractual right to collect the proceeds from its sale of raw gas. The court failed to realize that this reasoning makes the purchaser's, not the lessee's, point of sale the determining factor for calculating royalties.

In *Piney Woods*, the lessee was both the producer and processor of the gas. The lessee transported the gas to its plant for processing into usable products. After processing, the lessee delivered the gas to its purchasers and received payment based on the amount of processed gas delivered.⁹² After discussing the meaning of "at the well,"⁹³ that court decided that a sale off the premises occurred when the lessee delivered processed gas to the purchaser.⁹⁴ Thus, the critical point of inquiry becomes: where did the lessee deliver the gas to the purchaser?

By applying this reasoning to the facts in *State v. Davis*, the sale occurs at the well. Davis, as lessee, delivered raw gas to Phillips, its purchaser, on the lease premises. Phillips transported and processed the raw gas and delivered processed gas to its purchaser. Therefore, Davis, as lessee, sold raw gas, and in contrast to *Piney Woods*, did not participate in the transportation or processing of the gas. In this case, Davis transferred title, possession and control of the gas to the purchaser, Phillips, when the gas entered Phillips' pipeline.⁹⁵ The delivery of the raw gas to the purchaser occurred on the premises, and thus, the sale occurred at the well. Upon delivery of the gas to Phillips, Davis no longer possessed any incidents of ownership to the raw gas.⁹⁶ The amount Phillips owed Davis for the raw gas became the only undetermined factor in the sale. Under the gas sales contract, Phillips compensated Davis for the raw gas based upon a percentage of the proceeds Phillips received from the resale of the processed gas.⁹⁷ Therefore, a present sale occurred on the lease premises with a price calculated on subsequent events.

The Kansas Supreme Court addressed the question of where the sale of gas occurred in both *Matzen*⁹⁸ and *Waechter*.⁹⁹ In both of those cases the Kansas Supreme Court focused its inquiry on where delivery to the purchaser occurred. Consistent with those cases a delivery of title, control, and possession at the well results in finding a sale at the well. Since Davis delivered title and control to Phillips on the lease premises,¹⁰⁰ the sale occurred at the well. The Texas Supreme Court's holding in *Exxon Corp. v. Middleton*¹⁰¹ further supports this analysis. There the court determined that the sale occurred when the lessee delivered the gas to its

91. *Davis*, 728 P.2d at 1111 (Urbigkit, J., dissenting).

92. *Piney Woods*, 726 F.2d at 229.

93. *Id.* at 231.

94. *Id.* at 232.

95. *Davis*, 728 P.2d at 1111 (Urbigkit, J., dissenting).

96. *Id.* at 1113.

97. *Id.* at 1112.

98. 233 Kan. 846, 667 P.2d 337, 348 (1983).

99. 217 Kan. 489, 537 P.2d 228, 248 (1975).

100. *Davis*, 728 P.2d at 1111 (Urbigkit, J., dissenting).

101. 613 S.W.2d 240 (Tex. 1981).

customers.¹⁰² Thus, in the jurisdictions previously analyzing where a sale of gas for royalty purposes occurred, the critical question became: where did delivery occur? Applying the analyses from these other jurisdictions results in finding the sale occurred at the well where Davis delivered title, possession and control of the gas to Phillips.

In *Piney Woods*, the delivery of possession and control occurred at the same place the purchaser determined the amount owed the lessee. In *Davis*, two sales occurred. The first sale consisted of a sale of raw gas from the lessee to Phillips. The second sale consisted of a sale of processed gas from Phillips to its purchaser. The lessee's, not the purchaser's, sale should be the controlling sale for royalty purposes. The Wyoming Supreme Court failed to address the question of where the lessee delivered possession and control of the gas to the purchaser. The court held that the passage of title did not determine where the sale occurred,¹⁰³ but it failed to continue its analysis. In so doing, the court disregarded the fact that Davis delivered possession and control to Phillips at the same time it delivered title. The passage of title by itself may not determine the point of sale,¹⁰⁴ but the lessee's, not the processor's, delivery of title, possession and control of the gas should have a bearing on where the sale occurred. Since the lessee owns the gas originally, his acts should determine the place of sale. When the lessee gives its ownership rights to the purchaser, the purchaser becomes the new owner of the gas. Thus, by focusing on where the lessee delivers title, possession and control to the purchaser, the lessee's acts, not the purchaser's, define where the sale occurred. Since the Fifth Circuit Court of Appeals, the Kansas Supreme Court, and the Texas Supreme Court all found delivery of possession crucial in determining where the sale occurred, the Wyoming Supreme Court should have at least addressed the question.

Application of Wyoming's Statutes on the Sale of Goods

The majority also overlooked Wyoming's statutes on sales and the Uniform Commercial Code. Since the statutes define a sale of minerals as a sale of goods,¹⁰⁵ the court should have used the Wyoming Statutes to determine where the sale occurred. Section 34-21-206(a) defines a sale as "the passing of title from the seller to the buyer for a price."¹⁰⁶ Davis not only passed title,¹⁰⁷ it also delivered possession and control to the buyer at the well. By doing so, Davis satisfied the first half of the sales definition.

The second half of the definition requires that the passage of title be for a price. The court concluded that since the price to Davis depended on Phillips' redelivery price, the sale did not occur at the well. In reaching this conclusion, the court failed to apply section 34-21-222 which deals

102. *Id.* at 245.

103. *Davis*, 728 P.2d at 1109.

104. *Id.*

105. WYO. STAT. § 34-21-207(a) (1977); see U.C.C. § 2-107(1) (1978).

106. WYO. STAT. § 34-21-206(a) (1977); see U.C.C. § 2-106(1) (1978).

107. *Davis*, 728 P.2d at 1109.

with an open price term.¹⁰⁸ This statute states that if the parties so intend they "can conclude a contract for sale even though the price is not settled."¹⁰⁹ Davis received a percentage of the proceeds Phillips received from the sale of the processed gas. Since a contract for sale can be concluded with an open price term, it certainly can be concluded with a factored price term.¹¹⁰ Thus, Davis satisfied the second half of the sales definition.

Applying the facts of this case to the statutory definition of a sale, the sale occurred when Davis passed title, possession and control of the gas to Phillips for a price to be determined upon resale. Since, under the terms of the gas sales contracts, delivery of title and possession occurred at the inlet of Phillips' facilities¹¹¹ located on the lease premises, the sale occurred at the wells. Thus, under the statutory definition of a sale, the sale occurred at the wells, and Davis owed royalties on the amount realized from such sale.

Policy Reasons

According to the royalty provision in the lease, the State receives royalties based upon either the amount realized or the market value. For sales at the well, royalties were to be based upon amount realized, and for sales off the premises, royalties were to be based upon market value.¹¹² This provision makes the point of sale the determining factor in deciding which royalty clause applies.

Since the lessee produces and sells the gas, the lessee's acts determine which royalty provision applies. If the lessee can find a buyer for the gas at the well, then it pays royalties on the amount realized from such sale. If the lessee has to transport the gas off the premises to a buyer, then it pays royalties on the market value at the well. Since the State, as lessor, drafted the lease,¹¹³ it gave to the lessee the power to determine which royalty clause applied. If the State did not want to relinquish this right, it could have redrafted the lease to provide that all royalties be based upon market value.

The State's lease form has contained this royalty provision since 1960,¹¹⁴ and the State has permitted no bilateral negotiation of any provision in the lease. Therefore, the State has had ample time and opportunity to modify the royalty provision. Since the State did not change or modify the royalty provision, the State must have intended to give both royalty provisions their effect. By giving both royalty provisions effect, the lessee's act of selling the gas determines which royalty provision applies. Davis delivered title, possession and control of the gas to Phillips on the lease premises. Therefore, under both the Wyoming statutes and

108. WYO. STAT. § 34-21-222(a) (1977); see U.C.C. § 2-305(1) (1978).

109. *Id.*

110. *Davis*, 728 P.2d at 1117 (Urbigkit, J., dissenting).

111. *Id.* at 1111.

112. *Id.* at 1108 (majority opinion).

113. *Id.* at 1114 (Urbigkit, J., dissenting).

114. Brief for Appellee, *supra* note 8, at 23.

the test established by courts in other jurisdictions, the sale occurred at the well and royalties should have been due on the amount realized from such sale.

The State chose to keep the royalty provision in the lease and rely on the lessee's own self-interest¹¹⁵ in maximizing the royalty due the State. The lease also contains both lessor approval and federal floor provisions¹¹⁶ to insure adequate payment of royalties. Therefore, in drafting the lease the State must have determined that the lease provisions adequately protected its interests. The Wyoming Supreme Court should not have interpreted the lease in the State's favor just because the State desired royalties based upon market value.

CONCLUSION

In holding that royalties due the state should be calculated based upon market value, the Wyoming Supreme Court failed to apply both precedent and the Wyoming statutes. The court misinterpreted the holding in *Piney Woods* and focused on where Phillips determined the contract price. By doing so, the court failed to recognize that the crucial point of inquiry was: where did delivery of title, possession and control occur? Since Davis delivered title, possession and control of the gas to Phillips on the lease premises, the sale occurred at the well. The court failed to apply the Wyoming statutes on the sale of goods. By applying these statutes, the sale occurred on the lease premises, and therefore, the sale occurred at the well and royalties should have been based upon the amount realized. Thus, under both precedent and the Wyoming statutes the sale occurred at the well. The Wyoming Supreme Court erred in holding that Davis owed royalties based upon market value.

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115. *Davis*, 728 P.2d at 1108. For every dollar of gas sold, the lessee receives 7/8 and the lessor receives 1/8. *Id.*

116. *Id.* at 1109. For a discussion of the application of these provisions, see *State v. Moncrief*, 720 P.2d 470 (Wyo. 1986).