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Oil and Gas Law: *Hull v. Sun Refining and Marketing Company*: Are Division Orders a Condition Precedent to Payment or Merely an Oppressive Condition?

I. Introduction

Although there are several definitions for the term "division order,"¹ generally a division order is defined as a revocable authorization to the purchaser of oil and gas production (purchaser) for payment upon a stated basis to the owners of production.² It is revocable at the will of either party, but both are bound until the division order is terminated.³ Essentially, the instrument declares that portion of production to which each royalty interest owner is entitled. In addition, the instrument contains provisions relating to the computation of price, sellers' warranties, notice of change of ownership, and other similar relevant provisions.⁴

The purchaser, in order to protect itself, usually requires that all interest holders execute a division order.⁵ Such an act is necessary because when produced, oil and gas become the personal property of those persons holding an interest in the mineral estate.⁶ Therefore, to avoid liability for conversion, the purchaser has the obligation to determine the ownership of the personalty which he is receiving for his own use and to secure the agreement of the owners.⁷

While no authoritative source reveals the origin of the division order, it is often presented as though it was of divine origin⁸ or appeared on the scene "full grown like Athena from the head of Zeus."⁹ Whatever the origin, the division order first appeared on the judicial scene in 1899.¹⁰ Although it has undergone some changes through the years, the division

1. See generally 2 E. BROWN, LAW OF OIL AND GAS LEASES § 16.02(4)(D)(a) (2d ed. 1973); 4 H. WILLIAMS & C. MYERS, OIL AND GAS LAW § 701 (1981); Bounds, *Division Orders*, 5 INST. ON OIL & GAS L. & TAX'N 91 (1954).

2. R. HEMINGWAY, THE LAW OF OIL AND GAS § 7.5, at 336, 362 (2d ed. 1983).

3. *Id.* § 7.5, at 363.

4. *Id.*

5. *Id.*

6. Gregg, *Title Examination and Division Orders*, 19 INST. ON OIL & GAS L. & TAX'N 29, 30 (1968).

7. *Id.*

8. Hooper & Schleier, *Current Use and Effect of Division Orders*, 19 S. TEX. L.J. 531, 532 (1977).

9. Rain, *A Further Look at Division Orders & Problems in Accounting and Payment of Proceeds of Oil and Gas*, 8 ROCKY MTN. MIN. L. INST. 69,70 (1960).

10. *Childers v. Neely*, 47 W. Va. 70, 34 S.E. 828 (1899). *Childers* was filed as a bill in equity for dissolution of a partnership and for an accounting of all accounts including proceeds on oil sold by the partners by separate division orders.

order is, nevertheless, basically the same today as it was at the time of its origin.¹¹ Despite the industry's long-standing familiarity with the division order, certain issues pertaining to its use remain undecided. Whether a royalty interest owner is required to execute a division order as a condition precedent to payment of royalty proceeds is one such issue.¹²

This note will examine the law in Oklahoma as it pertains to the division order, focusing on the recent Oklahoma Supreme Court decision in *Hull v. Sun Refining & Marketing Co.*¹³ The note will also provide a review of the analysis employed by the *Hull* court. Finally, this note will discuss future implications for the oil and gas industry arising from *Hull*.

II. Background

A. Common Law

Prior to *Hull*, the common law was clear and unambiguous concerning the execution of a division order. In *Indian Territory Illuminating Oil Co. v. Killingsworth*¹⁴ the Supreme Court of Oklahoma found that at common law, a recognized custom and usage of the oil and gas industry required that all royalty holders must execute a division order before receiving royalty payments.¹⁵ Similarly, in *Wolfe v. Texas Co.*¹⁶ the United States Court of Appeals for the Tenth Circuit, interpreting Oklahoma trade usage, held that purchasers of oil and gas have the right to withhold payment of royalty proceeds, until furnished with an abstract showing marketable title and a division order executed by the lessor.

B. Legislative Enactment

In 1985, the Oklahoma legislature enacted title 52, section 540,¹⁷ which was intended to expressly govern the payment of royalties from oil and gas

11. Bounds, *supra* note 1, at 92.

12. See Holliman, *Division Orders — A Primer*, 34 OIL & GAS INST. 313, 332 (1983).

13. 789 P.2d 1272 (Okla. 1989).

14. *Indian Territory Illuminating Oil Co. v. Killingsworth*, 175 Okla. 78, 51 P.2d 505 (1935) (assignee of an oil and gas lease failed to notify the buyer of a change in the ownership of the lease, thereby causing that buyer to continue to pay the royalty owner as designated in a previous division order, was held liable to the buyers of the royalty interests; this was so notwithstanding the contention that the buyers of the royalty interest knew that the purchaser of the oil was paying another for their interests, and that by custom royalty oil was never paid for until division orders were properly executed by owners and furnished to the buyer).

15. *Id.*

16. 83 F.2d 425 (10th Cir.), *cert. denied*, 299 U.S. 553 (1936); *see also Wolfe v. Shell Petroleum Corp.*, 83 F.2d 438 (10th Cir.), *cert. denied*, 299 U.S. 553 (1936); *Wolfe v. Prairie Oil & Gas Co.*, 83 F.2d 434 (10th Cir. 1936).

17. 52 OKLA. STAT. § 540 (Supp. 1985). The section provides:

A. The proceeds derived from the sale of oil or gas production from any oil or gas well shall be paid to persons legally entitled thereto, commencing no later than six (6) months after the date of first sale, and thereafter no later than sixty (60) days after the end of the calendar month within which subsequent production is sold. Such payment is to be made to persons entitled thereto by the first purchasers of such production. Provided, such purchasers may remit to the

units.¹⁸ However, curiously absent from section 540 was any mention of division orders. That omission created uncertainty as to whether the legislature intended the statute to be interpreted as abrogating the common law requirement to execute a division order.

C. Recent Case Law

Seemingly, the Supreme Court of Oklahoma leaned toward an interpretation of section 540 requiring the execution of a division order in *Teel v. Public Service Co.*¹⁹ In dictum, the *Teel*²⁰ court stated that a division order consists of an agreement between the working interest owners and the purchasers which provides a payment formula for gas.²¹ Its function is to protect the purchaser from liability.²² Nonetheless, a purchaser is not protected unless the working interest owners sign a division order.²³ Accordingly,

persons entitled to such proceeds from production semiannually for the aggregate of six (6) months' accumulations of monthly proceeds of amounts less than Fifteen Dollars (\$15.00). Further provided, that any delay in determining the persons legally entitled to an interest in such proceeds from production caused by unmarketable title to such interest shall not affect payments to persons whose title is marketable. Provided however, that in those instances where such proceeds cannot be paid because the title thereto is not marketable, the purchasers of such production shall cause all proceeds due such interest to earn interest at the rate of six percent (6%) per annum, until such time as the title to such interest has been perfected. Marketability of title shall be determined in accordance with the then current title examination standards of the Oklahoma Bar Association. The first purchaser shall be exempt from the provisions of this subsection and the owner of the right to drill and to produce under an oil and gas lease or force pooling order shall be substituted for the first purchaser therein where the owner and purchaser have entered into arrangements where the proceeds are paid by the purchaser to the owner who assumes the responsibility of paying the proceeds to persons legally entitled thereto.

B. Any said first purchasers or owner of the right to drill and produce substituted for the first purchaser as provided herein that violates this act shall be liable to the persons legally entitled to the proceeds from production for the unpaid amount of such proceeds with interest thereon at the rate of twelve percent (12%) per annum, calculated from date of first sale.

C. The district court for the county in which the oil or gas well is located shall have jurisdiction over all proceedings brought pursuant to this act. The prevailing party in any proceeding brought pursuant to this act shall be entitled to recover any court costs and reasonable attorney's fees.

Id.

18. *Seal v. Corporation Comm'n*, 725 P.2d 278, 294 (Okla. 1986), *appeal dismissed*, 479 U.S. 1073 (1987).

19. 767 P.2d 391 (Okla. 1985) (section 540 was not directly applicable to *Teel* because the statute, prospective in nature, was enacted after the suit was filed).

20. *Id.* (an owner of a working interest in a gas well brought an action for accounting and termination of leasehold rights against the operators of gas well and the purchasers of the gas).

21. *Id.* at 397.

22. *Id.*; see *Bounds*, *supra* note 1, at 92.

23. *Id.*

the court recognized that in the absence of an executed division order, the purchaser could be found to have converted the production.²⁴

III. *Hull v. Sun Refining & Marketing Co.*

In *Hull v. Sun Refining & Marketing Co.*,²⁵ Robert Hull executed a mineral lease to Five Star Oil & Gas Company. Unquestionably, Hull had marketable title to all the oil, gas, and other minerals. That lease was subsequently assigned to Bill Andress, the lessee and operator at the time the well was drilled and completed. Andress, acting as agent for Hull, negotiated an oil purchase contract with Sun Refining and Marketing Company (Sun).

Sun was the first purchaser responsible for royalty payments to Hull. Therefore, on the basis of a division order title opinion, Sun submitted its standard division order to Hull for his signature. However, Hull refused to sign. Consequently, Sun refused to make royalty payments to Hull.

In the resulting lawsuit,²⁶ the Supreme Court of Oklahoma addressed the issue of whether a lessor is bound by a contract provision, implied under common law, requiring the execution of a division order as a condition precedent to the payment of royalty proceeds.²⁷ In a 5-4 opinion,²⁸ the court held that the only situation in section 540 that justifies suspension of royalty payments is the existence of unmarketable title.²⁹ Thus, the court concluded that section 540 abrogated the common law.³⁰

A. *Legislative Intent to Establish Marketable Title as the Standard for Payment*

As previously stated, royalty payments in Oklahoma from an oil or gas unit are expressly governed by section 540.³¹ Accordingly, the *Hull* majority initiated its opinion by establishing the standard for payment of royalty

24. *Id.*

25. *Hull v. Sun Ref. & Mktg. Co.*, 789 P.2d 1272 (Okla. 1989).

26. *Id.*

27. *Id.* at 1274; see also Legg & Murrah, *Royalty Payments — Who Owes How Much to Whom and When?*, 35 INST. ON OIL & GAS L. & TAX'N 159, 165 (1984) (stating that the cases are somewhat ambiguous on whether a purchaser can insist upon a signed division order before payment, but inferring that to depend upon requiring a division order is dangerous to the purchaser). *But see* Holliman, *supra* note 12, at 333 (where the interest owner has not elected to take his share of the production in kind, thereby designating the lessee as its marketing agent, the purchaser may withhold payment of the share of the proceeds of production allocable to the interest of the uncooperative owner without liability until the division order is signed).

28. The opinion consists of three parts. Justice Kauger wrote the majority opinion with whom Chief Justice Hargrave and Justices Lavender, Doolin, and Wilson joined. Justice Simms wrote the dissenting opinion with whom Vice Chief Justice Opala and Justice Hodges and Summers joined.

29. *Hull*, 789 P.2d at 1274.

30. *Id.*

31. *Seal v. Corporation Comm'n*, 725 P.2d 278, 294 (Okla. 1986), *appeal dismissed*, 479 U.S. 1073 (1987).

proceeds, as expressed in section 540. Subsection 540(A) specifically states that royalty payments “shall be paid to persons legally entitled thereto.”³² In the event that some of the interest holders’ payments are suspended due to questionable title, subsection 540(A) nevertheless provides that this delay “shall not affect payments to persons whose title is marketable.”³³

The court interpreted the language in subsection 540(A) as indicating the legislature’s intent to establish marketable title as the standard for payment of royalty proceeds.³⁴ By using marketable title as a standard for payment under section 540, the legislature expressed its intent that suspension of royalty payments is proper only when a legitimate question as to marketability of title exists. Furthermore, the marketable title standard specifically creates guidelines, thereby avoiding needless litigation arising from suspended payments.³⁵ Therefore, to require the execution of a division order as a condition precedent to payment would create a condition for payment neither expressly nor impliedly imposed by the legislature.³⁶

B. Conflict Between Section 540 and the Common Law

Hull acknowledged that at common law, a recognized custom and usage of the oil and gas industry included the requirement that royalty holders execute a division order before receiving royalty payments.³⁷ However, statutes may abolish a common law right where the intention to do so is plainly expressed.³⁸ The court concluded that, although section 540 did not expressly state that the recognized common law custom and usage requiring the execution of a division order had been abrogated, the text of section 540 is conclusive. Under section 540, the only condition justifying suspension of royalty payments is a lack of marketable title. For that reason, the court found that the common law rule conflicted with section 540.³⁹ When conflict exists between a statute and a custom and usage, the statute controls.⁴⁰

When a statute is enacted for the purpose of preventing an act, e.g., the needless suspension of royalty proceeds, no custom can prevail over its provisions.⁴¹ Thus, the court ruled that an interpretation that the common law rule survived the enactment of section 540 would contravene the statute in two ways. First, such an interpretation would contravene the statute’s express provision requiring payment to parties with marketable title. Second,

32. See *supra* note 17.

33. *Id.*

34. *Hull*, 789 P.2d at 1277.

35. *Id.*

36. *Id.*

37. *Id.* at 1278 (citing *Wolfe v. Shell Petroleum Corp.*, 83 F.2d 438, 442 (10th Cir.), *cert. denied*, 299 U.S. 553 (1936)); *Wolfe v. Texas Co.*, 83 F.2d 425 (10th Cir.), *cert. denied*, 299 U.S. 553 (1936); *Indian Territory Illuminating Oil Co. v. Killingsworth*, 175 Okla. 78, 51 P.2d 505, 506 (1935).

38. *Id.* at 1279 (citing *Reaves v. Reaves*, 15 Okla. 240, 82 P. 490, 495 (1905)).

39. *Id.*

40. *Id.* (citing *Smith v. Cox*, 301 P.2d 649, 651 (Okla. 1956)); see also *Franklin v. Shelton*, 250 F.2d 92, 96 (10th Cir. 1957), *cert. denied*, 355 U.S. 959 (1958).

41. *Id.*

allowing common law custom and usage to survive would permit purchasers to defeat the legislature's intent by withholding payment until lessors executed an unaltered document containing provisions which might contravene the lease and be unfavorable to the lessor.⁴²

Section 540 did not preclude negotiations between royalty owners and purchasers for the signing of a division order. However, the court clearly stated that purchasers may not, under the guise of custom and usage, impose unfavorable conditions on royalty owners, using a threat of suspended payment to coerce acquiescence.⁴³

C. Trade Usage Contrary to Public Policy

Both parties agreed that Andress acted as an agent for Hull in negotiating the contract for the sale of oil. Nonetheless, the parties disagreed over whether the custom and usage requiring the execution of a division order was included in the oil purchase contract.

The *Hull* court acknowledged that agents may contract and bind their principals to trade customs and usages.⁴⁴ However, the court specifically stated that such power does not extend to customs and usages which are either illegal or contrary to public policy.⁴⁵ The requirement that a lessor execute a division order before receiving royalty payments conflicts with the spirit and letter of section 540.⁴⁶ Therefore, it is violative of the public policy intended by the enactment of section 540—prompt payment to royalty owners of proceeds from the sale of oil or gas.⁴⁷ Consequently, the court found that the custom was not included in the oil purchase contract.⁴⁸

D. Methodology Incorrect

Justice Simms, Vice-Chief Justice Opala, and Justices Hodges and Summers dissented from the entire opinion, urging the majority to re-examine its interpretation of the legislative intent expressed in section 540.⁴⁹ The dissent concluded that section 540 did not plainly, or otherwise, express any intent to abolish the common law custom and usage requiring execution of division orders.⁵⁰

In addition, the dissent argued that the majority failed to justify the conclusion that unfair or unfavorable conditions might be imposed on the

42. *Id.*

43. *Id.*

44. *Id.* at 1280. See generally RESTATEMENT (SECOND) OF AGENCY § 34 (1957). The section provides, in pertinent part: "[A]n authorization is interpreted in light of all accompanying circumstances, including among other matters . . . (B) the general usages of business, the usages of trades or employments of the kind to which the authorization relates, and business methods of the principle." *Id.*

45. *Hull*, 789 P.2d at 1280 (citing *Hall v. Paine*, 224 Mass. 62, 112 N.E. 153, 158 (1916)).

46. *Id.*

47. *Id.*

48. *Id.*

49. *Id.* (Opala, V.C.J., Hodges, J., Simms, J., and Summers, J., dissenting).

50. *Id.*

royalty owner under the guise of custom and usage.⁵¹ Therefore, the dissent asserted that a correct interpretation of section 540 would necessarily involve upholding the common law requirement to execute a division order as a condition precedent to royalty payment.⁵²

IV. *Inconsistencies in the Hull Decision*

The *Hull* decision is inconsistent with both common law and the legislative intent of section 540. By holding that the custom and usage requiring the execution of a division order did not survive the enactment of section 540, the court created confusion in a well-settled area of law.

A. *Common Law Requirement Remains in Full Force and Effect*

Except as altered by constitution and statutes, the common law remains in full force and effect.⁵³ Accordingly, statutes may abolish a common law right where the intention to do so is *plainly expressed*.⁵⁴

By the court's own admission, section 540 did not plainly, or otherwise, express an intent to abolish the common law requirement to execute a division order.⁵⁵ In light of this admission, it is beyond question that the court should have held that section 540 should be construed in a manner consistent with the existing common law.⁵⁶ Instead, the majority erroneously advocated that the only prerequisite for payment is marketable title.

B. *Statutory Language Contemplates More Than Mere Marketable Title as the Standard for Payment of Royalty Proceeds*

Hull based its interpretation of section 540 primarily on the legislature's use of the term "shall."⁵⁷ Unquestionably, the term "shall" indicates a legislative mandate requiring interpretation.⁵⁸ The court, however, misinterpreted what "shall" references.⁵⁹

The statute's first reference to the term "shall" is that proceeds from production "*shall* be paid to persons legally entitled thereto, commencing

51. *Id.* at 1281.

52. *Id.*

53. 12 OKLA. STAT. § 2 (1981). Section 2 provides:

The common law, as modified by constitutional and statutory law, judicial decisions and the condition and wants of the people, shall remain in force in and of the general statutes of Oklahoma; but the rule of the common law, that statutes in derogation thereof, shall be strictly construed, shall not be applicable to any general statute of Oklahoma; but all such statutes shall be liberally construed to promote their object.

Id.

54. *See supra* note 38.

55. *Hull*, 789 P.2d at 1279.

56. *Id.* at 1281.

57. *Id.* at 1277.

58. *Id.*; *see Schaeffer v. Schaeffer*, 743 P.2d 1038, 1040 (Okla. 1987) ("shall" connotes mandatory duty when it is used in statute); *TIP Corp. v. Edmondson*, 630 P.2d 1296, 1297 (Okla. 1981) (word "shall" contained in statute connotes a mandatory duty).

59. *Hull*, 789 P.2d at 1277.

no later than six months after the date of first sale.”⁶⁰ While this phrase does mandate payment, it does not mandate payment to royalty owners on the basis of marketable title alone.⁶¹ Rather, the phrase indicates the legislature’s intent that royalty proceeds be paid to persons “legally entitled thereto,”⁶² which contemplates more than mere marketable title.⁶³

The statute’s second reference to the term “shall” states “that any delay in determining the persons legally entitled to an interest in such proceeds from production caused by unmarketable title to such interest *shall* not affect payments to persons whose title is marketable.”⁶⁴ Again, this provision does not require payment on the basis of marketable title alone. The provision was included in the statute merely to prevent the purchaser from suspending payment to *all* royalty owners simply because one owner’s title is in dispute.⁶⁵

While it is certainly true that a purchaser may withhold proceeds when title is not marketable,⁶⁶ demonstration of marketable title alone is not sufficient in and of itself to make an owner legally entitled to receive payment.⁶⁷ Accordingly, causes other than unmarketable title may exist which make an owner not legally entitled to receive payment.⁶⁸ Failure to execute a division order is one such cause under section 540 which must be met before a royalty owner would be legally entitled to be paid from proceeds.⁶⁹ Therefore, the court’s interpretation that the term “shall” required payment upon demonstration of marketable title alone⁷⁰ is unfounded.

C. Subsequent Legislation as a Guide to Determine the Legislative Intent of Section 540

When construing prior legislative enactments, subsequent legislation upon the same subject may be used to interpret the prior enactment.⁷¹ In addition, different legislative enactments pertaining to the same subject should be construed together as a harmonious whole.⁷² To determine the true legislative intent of section 540, the court should have examined title 52, section 540 of the Oklahoma Statutes (the 1989 amendment).⁷³ The 1989 amendment explicitly provides for the execution of a division order as a prerequisite

60. See *supra* note 17.

61. *Hull*, 789 P.2d at 1277.

62. See *supra* note 17.

63. See Appellant’s Brief in Support of Petition for Rehearing at 11, *Hull* (No. 71179).

64. See *supra* note 17.

65. See Appellant’s Brief in Support of Petition for Rehearing at 11, *Hull* (No. 71179).

66. *Hull*, 789 P.2d at 1277.

67. *Id.* at 1281 (Sims, J., dissenting).

68. *Id.*

69. *Id.*

70. *Id.* at 1277.

71. *Letteer v. Conservancy Dist. No. 30*, 385 P.2d 769 (Okla. 1963).

72. *Id.*

73. *Hull*, 789 P.2d at 1281 (Sims, J., dissenting).

for payment to royalty owners on and after the effective date of July 1, 1989.⁷⁴ Section 540(B) of the 1989 amendment⁷⁵ provides in pertinent part: "A division order is an instrument for the purpose of directing the distribution of proceeds from the sale of oil. . . . A division order *is executed* to enable the purchaser of the production from the leasehold to make remittance directly to the interest owners for their royalty interest. . . ."⁷⁶ Interpreting section 540 in view of the 1989 amendment, the court should have construed its language in a manner consistent with the existing common law requirement to execute a division order.⁷⁷

D. Comparison of Section 540 with Other States' Division Order Statutes

In support of its interpretation of section 540, *Hull* noted that commentators⁷⁸ emphasizing the importance of division orders to the oil and gas industry recognize that statutes similar to section 540 may require payment in the absence of an executed division order.⁷⁹ While this is true, the issue is not whether the legislature has the power to require payment without division orders, but whether section 540 was intended to accomplish that result.⁸⁰ A review of similar statutes adopted by other states demonstrates the intent to compensate owners for delays in receiving royalty proceeds by requiring the payment of interest, and not to eliminate the use of division orders.⁸¹ When a state intends to eliminate the requirement to execute division orders, that intent is clearly stated.⁸²

Several states have enacted statutes similar to section 540 requiring a purchaser to pay royalty proceeds to persons "legally entitled thereto."⁸³

74. *Id.*

75. 52 OKLA. STAT. § 540(B) (Supp. 1989). Subsection 540(B) was not directly applicable in *Hull* because the subsection only applied to division orders executed on or after July 1, 1989.

76. *Id.* § 540.

77. *Hull*, 789 P.2d at 1281.

78. See *Legg & Murrah*, *supra* note 27; *Holliman*, *supra* note 12, at 332 (while courts have approved the practice of using division orders and have recognized their usefulness, it appears that a party entitled to share in the proceeds from the sale of production cannot be required to sign a division order); *Twenhafel*, *Oil-Gas Division Orders: Their Origin, Varieties and Usage*, 27 ROCKY MTN. MIN. L. INST. 1479 (1982).

79. *Hull*, 789 P.2d at 1278.

80. See Appellant's Brief in Support of Petition for Rehearing at 11, *Hull* (No. 71179).

81. *Id.*

82. *Id.*

83. See ALA. CODE § 9-17-33 (Supp. 1982) ("The proceeds . . . shall be paid to persons legally entitled thereto . . . such payment is to be made to persons legally entitled thereto be the first purchasers of such production."); N.M. STAT. ANN. §§ 70-10-1 to -5 (Supp. 1987) ("The oil and gas proceeds . . . shall be paid to all persons legally entitled to such payments . . ."); TEX. CODE ANN. NAT. RES. §§ 91.401-.405 (Vernon 1988) ("Payee means any person or persons legally entitled to payment from the proceeds derived from the sale of oil . . ."); UTAH CODE ANN. § 40-6-9 (Supp. 1989) ("The oil and gas proceeds . . . shall be paid to all persons legally entitled to these payments . . .").

Like section 540, the statutes place no specific restrictions on the use of division orders.⁸⁴ Rather, the statutes impliedly recognize that causes other than unmarketable title may exist under which an owner may not be legally entitled to payment.⁸⁵

New Mexico⁸⁶ and Utah⁸⁷ have even gone so far as to enact statutes specifying other factors which, if present, prevent a person from being legally entitled to payment.⁸⁸ Among the reasons included in those statutes is failure to execute a division order.⁸⁹

In direct contrast to those statutes designed to define the time when payment should be made and to provide interest for delays are those statutes intended to eliminate the use of division orders.⁹⁰ When division orders are intended to be eliminated by statute, that intent is clearly expressed by the legislature.⁹¹ North Dakota's statute specifically states: "[R]oyalty payments may not be withheld because an interest owner has not executed a division order."⁹²

E. Common Law Requirement Does Not Violate Public Policy

In *Hull*, the court found that requiring a lessor to execute a division order before receiving royalty payments conflicts with the spirit and letter of section 540 and is violative of the public policy⁹³ intended by its enactment.⁹⁴ However, as stated, the majority failed to mention just what unfair or unfavorable conditions were imposed upon the royalty owner under the guise of custom and usage which would justify such a decision.⁹⁵ Neither the majority opinion nor the record⁹⁶ shows terms in the division order prepared by Sun which were unfair or oppressive.⁹⁷ Therefore, the court's

84. See Appellant's Brief in Support of Petition for Rehearing at 11, *Hull* (No. 71179).

85. *Id.* at 12.

86. N.M. STAT. ANN. § 70-10-5 (Supp. 1982).

87. UTAH CODE ANN. § 40-6-9 (Supp. 1989).

88. See Appellant's Brief in Support of Petition for Rehearing at 12, *Hull* (No. 71179).

89. See N.M. STAT. ANN. § 70-10-5 (Supp. 1987) ("The penalty provisions of the Oil and Gas proceeds payment Act [70-10-1 to 5] shall not apply in the following instances . . . [T]he party entitled to payment has failed to execute the payor's customary and reasonable division order . . ."); UTAH CODE ANN. § 40-6-9 (Supp. 1989) ("The penalty provisions of this chapter do not apply in the following instances: . . . The party entitled to payment has failed or refused to execute a division order . . .").

90. See Appellant's Brief in Support of Petition for Rehearing at 12, *Hull* (No. 71179).

91. *Id.* at 13.

92. N.D. CENT. CODE § 47-16-39.3 (Supp. 1987).

93. In *Hull*, the court stated that the public policy intended to be promoted was prompt payment to royalty owners of proceeds from the sale of oil or gas.

94. *Hull*, 789 P.2d at 1280.

95. *Id.* at 1282.

96. Sun's standard division order set forth the proportionate share of royalty each lessor was entitled to receive, the respective tax identification numbers and nine other covenants which covered: (1) the quality of the oil and how it will be measured; (2) commingling; (3) warranty of title; (4) oil sales; (5) passage of title; (6) change of interest; (7) tax deductions; (8) production standards; and (9) effective date of division order.

97. *Hull*, 789 P.2d at 1282.

assertion that the common law usage requiring the execution of a division order is violative of public policy is wholly unupportable.⁹⁸

*V. Conflict and Confusion in the Oil and Gas Industry
Resulting from the Court's Decision*

The importance of a division order is readily apparent. It establishes the legal relationship between the owners of the oil and the purchasing company, and is generally the first and only written relationship between the two parties.⁹⁹ Consequently, without an executed division order, it is uncertain whether a purchaser has the authority to take the production.¹⁰⁰ That uncertainty is further evidence that the court's interpretation of section 540 is incorrect, as its decision will only create conflict and confusion in the oil and gas industry.¹⁰¹ However, to fully appreciate the liability and burden the court's decision has placed on oil and gas purchasers, one must examine the specific customary provisions of a division order that afford protection and guidance to oil and gas purchasers.

A. Provision of a Division Order: Warranty

One of the first provisions of the division order is usually the warranty clause. The signatory warrants or certifies that he owns a specific interest in the minerals produced from the described premises.¹⁰² The clause is designed to protect the purchaser against improper payment in two specific situations: (1) where the seller does not actually have an interest in the minerals; and (2) where the size of his ownership interest is less than that described in the division order.¹⁰³

In the absence of a warranty of title, a purchaser who is held liable in tort for conversion to the true owner would have no means of recouping its loss.¹⁰⁴ However, if the distribution of the proceeds is made in accordance with the terms of a division order, the warranty clause will provide the purchaser with an action for breach of warranty against the recipient of the funds. The remedy is limited to the extent that the purchaser is held liable in damages to the rightful owner of production.¹⁰⁵ The warranty affords the purchaser with some measure of protection.

B. Provision of a Division Order: Change of Ownership

Mineral interests are freely alienable.¹⁰⁶ Therefore, without some form of protection, the transfer of a royalty or working interest could generate

98. *Id.*

99. Bounds, *supra* note 1, at 91.

100. Teel, 767 P.2d at 397.

101. See Appellant's Brief in Support of Petition for Rehearing at 14, *Hull* (No. 71179).

102. Holliman, *supra* note 12, at 318; see also Hooper, *supra* note 8, at 531.

103. *Id.*

104. *Id.*

105. See H. WILLIAM & C. MEYERS, *supra* note 1, § 704.1.

106. Holliman, *supra* note 12, at 331.

liability for a purchaser of production. Liability arises if, after the transfer has been consummated, the purchaser erroneously continues to pay the transferor.¹⁰⁷ Certainly this would be the case if the purchaser had actual notice of the transfer.¹⁰⁸ Some authority exists for such a result even if the notice is merely constructive rather than actual.¹⁰⁹

Notice problems associated with transfers make it desirable for a purchaser to include an express provision in its division orders relieving it of responsibility for payments made in compliance with the division order.¹¹⁰ This express provision is applicable unless the purchaser has received prior written notice of the change in ownership.¹¹¹ Accordingly, this provision eliminates the application of any constructive notice rule. It also protects the purchaser from liability for payments made to the transferor before receipt of written notice of the change in ownership.¹¹²

C. Provision of a Division Order: Pricing

A division order's most important provision sets the price to be paid for the production.¹¹³ While the pricing provision of an oil division order is quite simple,¹¹⁴ the pricing provision found in a gas division order is much more complex.¹¹⁵ In either case, without an executed division order, the purchaser will not have any agreement between itself and the royalty owner as to the price to be paid for royalty oil and gas.¹¹⁶

The complexities associated with valuing gas for revenue distribution purposes arise in the first instance from the language employed in typical lease royalty clauses to describe the lessee's royalty payment obligation.¹¹⁷

107. *Id.*

108. *Id.* This follows from the premise that oil and gas when produced become the personal property of those owning the substance and the purchaser, in order to avoid liability for conversion, must determine the ownership of the personalty he is receiving and secure the agreement of the owners to its purchase. H. WILLIAM & C. MEYERS, *supra* note 1, § 704.9 (1962).

109. See *Shell Petroleum Corp. v. Royalty Petroleum Corp.*, 111 S.W.2d 1178 (Tex. Civ. App. 1937), *aff'd in part, rev'd in part*, 135 Tex. 12, 137 S.W.2d 753 (1940) (recording a change in mineral interest ownership is sufficient notice to the purchaser of such transfer in the absence of more stringent contractual requirements)

110. Holliman, *supra* note 12, at 331.

111. *Id.*

112. See *Bounds*, *supra* note 1.

113. Hooper & Schleier, *supra* note 8, at 542.

114. Accounting to the payee under an oil division order usually is made on the basis of the posted price for the grade and gravity of crude oil involved as applicable to the particular field of production. Holliman, *supra* note 12, at 327. The term "posted price," as used in this context, refers to a written statement of crude oil prices circulated publicly among buyers and sellers of crude oil in a particular field reflecting the price per barrel that a crude oil purchaser will pay for a specified quality crude produced from that field. H. WILLIAMS & C. MEYERS, *OIL & GAS LAW MANUAL OF TERMS* 557-58 (1969).

115. Holliman, *supra* note 12, at 327.

116. Hooper, *supra* note 8, at 546.

117. Holliman, *supra* note 12, at 546.

That complexity is further compounded by the marketing alternatives attendant to the disposition of gas.¹¹⁸

Royalty clauses often describe the royalty obligation with respect to gas as being the duty to pay the "market value at the well" of a fractional part of the production.¹¹⁹ Thus, in the absence of some contrary directive, a distribution of revenue pursuant to a division order would first require the determination of the market value of the gas allocable to the interest of each division order signatory.¹²⁰ Because the lease usually does not provide a specific definition of the term "market value," parties to division orders have become accustomed to using the division order provisions to express how the market value of the gas will be determined.¹²¹ Most modern gas division orders provide that settlement as to gas which is sold shall be made on the basis of the net proceeds¹²² realized at the well from the sale of gas.¹²³ As a result, purchasers and lessors alike have a convenient method for determining the market value of gas and the distribution of revenues allocable to its sale.¹²⁴

VI. Conclusion

At common law in Oklahoma, a recognized custom and usage of the oil and gas industry requires a lessor to execute a division order as a condition precedent to receipt of royalty payments. Except as altered by constitution and statutes, the common law remains in full force and effect. A statute may abolish a common law right, although its intention to do so must be clearly expressed. In this regard, *Hull* recognized that section 540 did not plainly, or otherwise, express any intent to abolish the common law. Therefore, there should be no doubt that the custom and usage, requiring execution of a division order, remains in full force and effect.

Furthermore, when construing prior legislative enactments, subsequent legislation upon the same subject may be used to interpret the prior enactment. The 1989 amendment to section 540 explicitly provides for the execution of a division order as a prerequisite for payment to royalty owners. Accordingly, interpreting section 540 in view of the 1989 amendment, it is obvious the legislature intended that section 540 be construed in a manner consistent with the common law.

The *Hull* decision is inconsistent with both the common law and the legislative intent in section 540. By asserting that section 540 abrogated the long-standing custom and usage in the oil and gas industry requiring the

118. *Id.*

119. *Id.*

120. *Id.* at 328.

121. *Id.*

122. Net proceeds is defined within the clause to mean the price received for the gas less the cost of compressing, treating, dehydrating, and transporting the gas or otherwise placing it in marketable condition. Holliman, *supra* note 12, at 328.

123. *Id.*

124. *Id.*

execution of a division order, *Hull* has brought conflict and confusion to a well-settled area of law.

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