IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 94-60450

KILLAM OIL COMPANY and
HURD ENTERPRISES, LTD.,

Plaintiffs-Appellants,

and

RADCLIFFE KILLAM, ET AL.,

Intervenors-Appellants,

versus

AMOCO PRODUCTION CO.,

Defendant-Appellee.

Appeal from the United States District Court for
the Southern District of Texas
(CA-L-92-23)

(May 15, 1995)

Before POLITZ, Chief Judge, REAVLEY and EMILIO M. GARZA, Circuit Judges.

REAVLEY, Circuit Judge:*

*Local Rule 47.5 provides: "The publication of opinions that have no precedential value and merely decide particular cases on the basis of well-settled principles of law imposes needless expense on the public and burdens on the legal profession." Pursuant to that Rule, the Court has determined that this opinion should not be published.

Appellants Killam Oil Company et al. appeal a summary judgment granted against them and in favor of Amoco Production Company (Amoco). We affirm.

BACKGROUND

Appellants Killam Oil Co. and Hurd Enterprises, Ltd. ("Killam & Hurd") are successors in interest to Killam & Hurd, Ltd., a partnership whose general partners were Radcliffe Killam and John G. Hurd. They owned about 30,000 acres on which they wanted to develop oil and gas production. Killam & Hurd, Ltd. and Amoco entered into a "letter agreement" or "exploration agreement" and related oil and gas leases. Under the letter agreement Amoco was to drill wells and was entitled to all the production from a given well until it reached payout, i.e. recovery of Amoco's costs. After payout was reached on a well, half of the working interest would be reassigned to Killam & Hurd, Ltd. There is no dispute that *prior* to payout Amoco had to obtain approval from Killam & Hurd to sell production. Paragraph 9 of the letter agreement states:

> No leasehold assignment or any contract for the sale of products executed by Amoco shall be valid on either Amoco or Killam until Killam shall have approved in writing such assignment or contract.

Paragraph 8 of the agreement, however, states:

> As each producing well drilled under the provisions hereof reaches the point of payout so that Killam then will be the owner of a working interest in the properties surrounding said well, all future operations upon said well and the proration unit surrounding same shall be conducted under the provisions of a Joint Operating Agreement, a copy of which is attached hereto as Exhibit "B."

Under the joint operating agreement (JOA), Amoco had the right to market its own gas without Killam & Hurd's approval. The JOA provides:

> Each party shall have the right to take in kind or separately dispose of its proportionate share of all oil and gas produced from the Contract Area . . . .

As operator, Amoco also had the right under the JOA to market a non-operator's gas when the non-operator failed to do so, subject to the non-operator's right to resume its own marketing at any time:

> In the event any party shall fail to make the arrangements necessary to take in kind or separately dispose of its proportionate share of the oil and gas produced from the Contract Area, Operator shall have the right, subject to the revocation at will by the party owning it, but not the obligation, to purchase such oil and gas or sell it to others at any time and from time to time, for the account of the non-taking party at the best price obtainable in the area for such production. Any such purchase or sale by Operator shall be subject always to the right of the owner of the production to exercise at any time its right to take in kind, or separately dispose of, its share of all oil and gas not previously delivered to a purchaser.

The JOA went on to provide that if one party takes and sells more than its proportionate share of the gas, accounting for the parties' interests shall be in accord with a Gas Balancing Agreement (GBA), attached as an exhibit to the JOA:

> In the event one or more parties' separate disposition of its share of the gas causes split-stream deliveries to separate pipelines and/or deliveries which on a day-to-day basis for any reason are not exactly equal to a party's respective proportionate share of total gas sales to be allocated to it, the balancing or accounting between the respective accounts of the

> parties shall be in accordance with any Gas Balancing Agreement between the parties hereto . . . .

The GBA provides that when one party is not marketing its share of the gas the other party may do so:

> During the period or periods when any party has no market for its share of gas produced from any proration or spacing unit within the contract Area, or its purchaser does not take its full share of gas produced from such proration or spacing unit mentioned above, the other parties shall be entitled to produce each month one hundred percent of the allowable gas production assigned to such proration or spacing unit by the State regulatory body having jurisdiction and shall be entitled to take and deliver to its or their purchaser or purchasers all of such gas production. . . . [T]he party or parties taking such gas shall own all of the gas delivered to its or their purchaser or purchasers.

The GBA went on to provide that the operator shall maintain a gas account to show the gas balance existing among the parties, and that if a gas imbalance exists at the time the well is depleted, the overproducing party or parties shall make a cash payment to the underproducing party or parties.

The parties had a disagreement regarding gas sales because Killam & Hurd thought that prices were depressed and wanted production slowed. This suit followed. Killam & Hurd claimed that Amoco had no right under the agreements to sell gas after payout without their approval. Intervenors Radcliffe Killam et al. had succeeded to Killam & Hurd, Ltd.'s leasehold and royalty interests. They claimed to be third party beneficiaries to the agreements, and also claimed that Amoco had breached it duty as an oil and gas lessee to reasonably market the gas, by selling it in a depressed market. Both sides moved for summary judgment.

The district court agreed with Amoco, entering summary judgment in its favor.

DISCUSSION

A. *Contract Interpretation*

Amoco's position is that after payout, if Killam & Hurd failed to take their proportionate share of the gas produced, Amoco as operator could sell as much gas as it wanted without Killam & Hurd's approval, so long as it paid Killam & Hurd their share of the proceeds. Killam & Hurd contend that under paragraph 9 of the letter agreement Amoco was required to obtain their approval for sales after payout.

We conclude that under long-recognized rules of contract construction, Amoco's position must prevail. "On appeal, a district court's interpretation of a contract is a matter of law reviewable *de novo*. . . . This broad standard of review includes the initial determination of whether the contract is ambiguous." *American Totalisator Co. v. Fair Grounds Corp.*, 3 F.3d 810, 813 (5th Cir. 1993). Texas substantive law governs this diversity case. "Under Texas law, a contract is ambiguous only when the application of pertinent rules of construction leave it genuinely uncertain which one of two reasonable meanings is the proper one. *Chemical Distributors, Inc. v. Exxon Corp.*, 1 F.3d 1478, 1481 (5th Cir. 1993).

Two specific Texas rules of contract construction apply here. First, contemporaneously executed agreements should be construed together. In another case involving an oil and gas letter agreement and operating agreement, we noted that "[a]s with any set of documents executed at the same time, with the same purpose and in the course of the same transaction, we construe the agreements together." *Calpetco 1981 v. Marshall Exploration, Inc.*, 989 F.2d 1408, 1412 (5th Cir. 1993) (citing *Jim Walter Homes, Inc. v. Schuenemann*, 668 S.W.2d. 324, 327 (Tex. 1984)). Second, whenever possible contractual provisions should be harmonized so as to give effect to all of them. "When the provisions of a contract appear to conflict, they should be harmonized if possible to reflect the intentions of the parties. The parties to a contract intend every clause to have some effect and a court will not strike down any portion of the contract unless there is an irreconcilable conflict." *Edlund v. Bounds*, 842 S.W.2d 719, 726 (Tex. App.--Dallas 1992, writ denied) (citation omitted).

Amoco's interpretation of the agreements harmonizes their terms. Since the JOA does not require written approval from Killam & Hurd before Amoco can sell gas, and the letter agreement does, the two can only be harmonized by limiting paragraph 9 of the letter agreement to the period before payout. Paragraph 8 of the letter agreement confirms this interpretation, since it unambiguously states that after payout future operations of the well are governed by the JOA.

We might pause in our analysis if this interpretation were unreasonable, for "[c]ourts will avoid when possible and proper a construction which is unreasonable, inequitable, and oppressive." *Reilly v. Rangers Management, Inc.*, 727 S.W.2d 527, 530 (Tex. 1987). Our interpretation, however, does not lead to an unreasonable result. There are practical reasons why non-operators would have special concerns about the operator's sale of gas prior to payout. They may be wary of the operator's desire to receive the best possible price prior to payout, since the operator may be contracting for a higher price for other production and delaying payment here in order to receive all of the gas for a longer period of time. As the district court noted: "Before a well reaches payout, plaintiffs do not own a working interest in the well and their interest is in seeing that payout occurs as soon as possible and that defendant does not deplete more reserves than necessary in reaching that point."

B. *Covenant to Reasonably Market*

The intervenors hold royalty and leasehold interests originally belonging to Killam & Hurd, Ltd. They argue that as royalty owners they are entitled to assert the implied covenant to reasonably market the gas. The intervenors claim that this covenant was violated when Amoco continued to sell in the face of a downturn in the market.

Under Texas law:

> [T]here are three broad categories of covenants implied in all oil and gas leases. These implied covenants obligate the lessee to: (1) reasonably develop the premises, (2) protect the leasehold, and (3) manage and administer the lease. Included within the covenant to manage and administer the lease is the duty to reasonably market the oil and gas produced from the premises. This duty is also two-pronged: The lessee must market the production with due diligence and obtain the best price reasonably possible. Under a gas royalty clause providing for royalties based on market value, the lessee has an obligation to obtain the best *current* price reasonably available. The standard of care applied to test the performance of the lessee in

> marketing the gas is that of a reasonably prudent operator under the same or similar circumstances.

Cabot Corp. v. Brown, 754 S.W.2d 104, 106 (Tex. 1987) (citations omitted, emphasis added).

The issue here is whether an operator subject to the implied covenant to reasonably market can be held liable for selling at market prices when the market is depressed. The intervenors cite no authority that a "reasonably prudent" operator is charged with the ability to predict future market prices. They conceded at oral argument that no such authority exists. Absent such authority, we conclude that Texas courts would not extend the covenant this far. Indeed, an operator with such talent would have little need to bother with drilling wells; he could stay home and make a fortune playing the market.

AFFIRMED.