

MINUTES OF A MEETING OF THE BOARD OF DIRECTORS OF
TARRANT COUNTY WATER CONTROL AND IMPROVEMENT DISTRICT NUMBER ONE
HELD ON THE 7TH DAY OF FEBRUARY, 1977 AT 10:00 A.M.

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The call of the roll disclosed the presence or absence
of Directors as follows:

<u>PRESENT</u>	<u>ABSENT</u>
Wayne E. Newton	C. Victor Thornton
J. Oliver Shannon	Clyde A. Penry
Murray Kyger	

Also present was Mr. Ben Hickey, General Manager of the District.

Director Newton acted in his capacity as President and
Director Shannon acted in his capacity as Secretary, whereupon pro-
ceedings were had and done as follows:

1.

On motion duly made and seconded, the minutes of the
meeting held January 24, 1977 were read and approved by the
Directors and it was accordingly ordered that such minutes be placed
in the permanent files of the District.

2.

Mr. Newton presented the following letter for the Director's
consideration, to wit: December 2, 1976

Mr. Ben Hickey
Tarrant County Water Control and
Improvement District Number One
P.O. Box 4508
Fort Worth, Texas 76106

Dear Ben:

I enclose the following:

1. Memorandum as to the facts and applicable authorities
concerning the rights of the District with respect to
Lone Star Gas and Mitchell;

2. Detailed statement of the time and charges therefor (\$8,921.22).

It certainly is proper that the matter should go to the Board, and I trust that the enclosures are appropriate for that purpose. If not, please inform me.

The nature of the claim is such that anything less than a careful investigation would not, I am afraid, have been helpful to the Board or you, although we did proceed as fast as possible because time may be running against the District instead of in favor of the District.

The enclosed Memorandum outlines some of the facts and the applicable authorities supporting our conclusion that the District has a valid claim for additional payments for royalties on gas produced and to be produced, but it may be helpful to estimate in a general way the dollar amounts involved.

Based on information furnished us by the District, it appears that Lone Star for the period January 1, 1973 through July 31, 1976, has paid the District a total of about \$200,000 for gas, and such payments average out to about 20 cents per m.c.f. As indicated in the Memorandum, the price for gas currently being paid in Wise County ranges from \$1.45 to \$2.00 per m.c.f., and prices began to increase sharply in 1973. Assuming that the market value figure for 1973 through 1976 would average out to 80 cents per m.c.f. for that period, the District should have received about \$800,000 from Lone Star instead of \$200,000.

We have also been told that Mitchell has been paying the District at the same rate of 20 cents per m.c.f., and that the total paid by Mitchell is about the same as the total paid by Lone Star, i.e., about \$200,000 for 1973 through summer of 1976. It would appear, therefore, using the same assumed average price of 80 cents per m.c.f. as market value, that the District should also have received from Mitchell a total of \$800,000 instead of \$200,000.

In summary, the District has been paid about \$400,000 by both for that period of time and probably should have been paid about \$1,600,000.

Royalties for future production, if current price is used as market value for calculating royalties to the District, should be at the rate of somewhere between \$1.45 and \$2.00 per m.c.f. Of course, the dollar total of future royalties depends on the amount and duration of production as well as price, and we have no information as to probable life of the properties.

The claim of the District will undoubtedly be strongly resisted by Lone Star, and consideration should also be given

to the possibility that Lone Star might stop paying even on the basis of 20 cents per m.c.f. when the claim is asserted. If it is necessary to revoke the existing division orders, it is almost certain that Lone Star would attempt to withhold payment of royalties until the dispute is resolved, which might be many months.

Our conclusions are based on research, examination of records and evidence furnished by the District. We have attempted to make an investigation without Lone Star's knowledge, and we do not know what Lone Star's files may reflect.

If you need anything else, please inform me.

Sincerely yours,

/s/ Alex Pope

Alex, Pope, Jr.

MEMORANDUM

We have analyzed two oil and gas leases executed by the District in the 1950's, covering lands in Wise County, Texas, which have been assigned in whole or in part to Lone Star Producing Company.

The first such lease is dated November 20, 1952, between the District and C. L. Gage, Lessee. The gas royalty clause reads as follows:

"In consideration of the premises the said lessee covenants and agrees to pay or cause to be paid to lessor during the term hereof the following royalty on all oil, gas and other minerals produced and saved from leased premises::

"(b) As a royalty on dry gas, by which is meant the gas from a well where gas only is produced, the value of one-eighth (1/8) part of all dry gas sold or used. The value of the gas is to be based upon the highest market price paid or offered in the general area or that part which accrues to the producer, or as may be fixed by or under authority of law, whichever is the greatest; but in no event shall this value be computed at less than six (6) cents a thousand cubic feet.

The other lease is dated October 18, 1954, also between the District and C. L. Gage as Lessee. The gas royalty provision

is as follows:

"In consideration of the premises the said Lessee covenants and agrees to pay or cause to be paid to Lessor during the term hereof the following royalty on all oil, gas and other minerals produced and saved from the leased premises:

"(b) As a royalty on dry gas, by which is meant the gas from a well where gas only is produced, the value of one-eighth (1/8) part of all dry gas sold or used. The value of the gas is to be based upon the highest market price paid in the general area for that part which accrues to the producer, or as may be fixed by or under authority of law, whichever is the greatest; but in no event shall this value be computed at less than ten (10) cents a thousand cubic feet for gas deliverable against a pipe line pressure or at least eight hundred pounds per square inch.

Under Payments by Lone Star

After reviewing the leases referred to, we requested, and were furnished by the District, information as to gas royalties being paid. The information furnished us reflected that the District is being paid, on an average, about 20 cents per m.c.f. by Lone Star Producing Company and Enserch Exploration, Inc., for gas sold under these two leases.

We also obtained records of the Railroad Commission as to the applicable rules and orders for the land where the wells of the District are located.

After discussing the price of gas with people who have knowledge of gas prices being paid in the Wise County area, we concluded that the present actual market value for gas in that area currently ranges between a low of \$1.45 per m.c.f. (the low being paid by Lone Star and Enserch) and a high of \$2.00 per m.c.f. The current price has reached its present level after a rapid rise commencing about 1973. The statutes of limitations applicable is the four-year statute.

Based upon the language of the royalty clauses in the leases and the current market price of gas in Wise County, we concluded that the District has a cause of action to recover the market value of the gas produced under these two leases, under Texas Oil & Gas Corp. v. Vela, 429 S.W.2d 866 (Tex.Sup. 1968), J. M. Huber Corp. v. Denman, 367 F.2d 104 (5th Cir. 1966) and related cases, unless the District had signed something which constituted a waiver of the cause of action or which estopped the District from asserting it.

Division Orders

In connection with the issues of waiver and estoppel, we requested and were furnished a large number of division orders executed by the District relating to these two leases to Lone Star.

We find nothing in the division orders which would prevent the District from asserting a cause of action to recover the market value of its gas.

We did find a reference in the division orders to a Gas Purchase Contract dated as of January 1, 1957, between Lone Star Producing Company, as Seller, and Lone Star Gas Company, as Buyer. We found nothing in this Gas Purchase Contract that would foreclose the assertion of the cause of action by the District. To the contrary, we found that the Gas Purchase Contract contains a "most favored nation clause", which requires Lone Star Gas Company to pay to Lone Star Producing Company the highest price paid by it for like gas in Jack, Parker or Wise Counties. It is our understanding of the facts that such payments have not been made, and therefore there probably has been a breach of the "most favored nation clause" in the Gas Purchase Contract which could be asserted by the District, in addition to its right to recover the highest market price paid for gas in the general area.

The Gas Purchase Contract expires after 20 years (January 1, 1977), although in the division orders the District has agreed to any "supplements and amendments thereto and modifications and replacements thereof and substitutions therefor, in whole or in part. . ." and therefore, an extension of the Gas Purchase Contract of January 1, 1957, may be asserted as binding by virtue of the language in the division orders. Nevertheless, we feel that the District has a valid claim to higher gas royalty payments (on an m.c.f. basis) in the future, though it may require the revoking of the existing division orders.

Under Payment by Mitchell

We believe that a similar cause of action very probably exists against George Mitchell & Associates (or its successor in title), the assignee of part of the 1952 and 1954 leases described. We have not had an opportunity to review the division orders, gas purchase contracts and other instruments that might be involved, so we express no opinion as to any cause of action against George Mitchell & Associates, until we have examined the relevant instruments. However, it has been held that although the Federal Power Commission has jurisdiction to regulate the price of gas sold in interstate commerce (which we understand is the case with gas sold by Mitchell), the fixing of a price by the FPC does not vitiate Mitchell's duty to pay the District for the market value of its gas, even though the market price owed to the District is higher

than the FPC price. See, for example, Mobil Oil Corp. v. Federal Power Commission, 463 F.2d 256 (D.C. Cir. 1971), cert. den., 406 U.S. 976 (1972).

Other Underpayment Suits

We knew that the State of Texas had filed suits against other producing companies for additional gas royalties, and that the suits were settled on a basis that was quite favorable to the State (landowner). Accordingly, in view of the sums involved for the District, we went to Austin to discuss the suits with the Assistant Attorney General who handled the cases, to obtain information relative to gas royalties from the General Land Office, and to examine records of the Travis County District Court where the litigation was filed. Lone Star Gas Company had not been sued, but most of the major producers in Texas had been, such as Gulf Oil Corporation, Exxon, and Texaco, Inc. These suits resulted very favorably for the State, both as to recovery of unpaid gas royalties for "market value" in the past and renegotiation of gas royalties for the future.

Based upon the foregoing, it is our opinion that the District has not been paid "market value" for the gas produced under the leases of 1952 and 1954. We feel that the District is legally entitled to recover additional gas royalties for past production and is also entitled to increased gas royalties for future production.

Following the reading of the above letter and memorandum a general review of the matter was given by management of the District with a recommendation that authority now be given management of the District to initiate proceedings to recover the market value of gas produced under leases now held by the District.

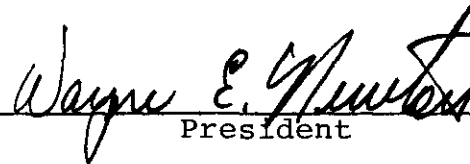
Whereon, Director Kyger made a motion, seconded by Director Shannon and unanimously approved, that management, working with General Counsel of the District, be now authorized and given full authority to do all things necessary in the recovery of past and future market value royalty payments for gas produced under leases now held by District; and further that an agreement, subject to approval of the Directors, for engaging the services of the firm of

Pope, Hardwicke, Christie, Montgomery and Rehfeldt, recognized authorities on oil and gas matters, to represent the District in the recovery of said market value royalty payments be entered into.

3.

There being no further business before the Board of Directors, the meeting adjourned.


Secretary


President