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REGULATION OF THE OIL AND GAS INDUSTRY BY THE OKLAHOMA CORPORATION COMMISSION

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Since its creation in 1907, the Oklahoma Corporation Commission has developed extensive regulatory powers over the state's energy industry. This Article sketches the development of these powers, focusing primarily on two important conservation devices: the drilling and spacing unit and the forced pooling order. The authors discuss the purpose and practical application of these concepts and examine recent statutory and case law affecting their operation.

Early drillers began exploring for and producing oil and gas in Oklahoma prior to statehood. The first major discovery in the state, the Glenn Pool, occurred in 1905 in what was then Indian Territory. The rapid development of the Glenn Pool and other fields quickly made Oklahoma one of the major producing states in the nation. This heritage continues today; with the exception of Texas, more wells were drilled in Oklahoma in the early 1980's than were drilled in any other state in the

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nation.¹

Oklahoma currently has approximately 100,000 producing oil wells and 24,000 producing gas wells within its borders.² These wells contribute approximately ten percent of the nation's natural gas supply and five percent of its crude oil supply.³ In 1984, Oklahoma produced a record-setting 2.091 trillion cubic feet of natural gas and averaged 460,000 barrels of oil per day.⁴ In addition, approximately 15,000 disposal and injection wells are located in the state, disposing of saltwater and deleterious substances produced in conjunction with hydrocarbons.⁵

The Oklahoma Corporation Commission has been given the responsibility of regulating the oil and gas industry, and the majority of its resources are dedicated to this objective. In 1982, approximately two-thirds of the total applications filed with the Commission related to oil and gas matters.⁶ Although the Commission is currently extensively involved in regulation of the oil and gas industry in Oklahoma, this has not always been true.

The purpose of this Article is to examine the creation of the Oklahoma Corporation Commission, its powers to regulate the oil and gas industry, and, specifically, the power of the Commission to establish drilling and spacing units and to force pool mineral and leasehold interests.⁷

I. CREATION OF THE COMMISSION

A. *Introduction*

After success in Pennsylvania and Ohio, the early drillers migrated

1. Oklahoma Corporation Commission memorandum from Rick Conner to W. Timothy Dowd (June 12, 1985). During 1984, 10,053 wells were completed in Oklahoma, making it the third best drilling year in Oklahoma history. In 1982, 12,030 wells were drilled in Oklahoma, as compared to the 11,699 wells drilled in 1981. *Id.* at 1.

2. *Id.* at 2. Approximately 80% of the Oklahoma oil wells are classified as "stripper" wells, oil wells that average less than ten barrels of oil per day. Because many of Oklahoma's oil wells are marginal, the average production rate per well is around 4.6 barrels per day. See INTERSTATE OIL COMPACT COMMISSION, IMPACT OF DECREASING CRUDE OIL PRICES ON STRIPPER OIL WELLS (1985).

3. INTERSTATE OIL COMPACT COMMISSION, PRODUCTION STATISTICS 5-27 (1985).

4. Memorandum, *supra* note 1, at 2.

5. *Id.* at 4.

6. OKLAHOMA SENATE COMMITTEE, OIL AND GAS REGULATION IN OKLAHOMA: A COMPARATIVE STUDY (1983) (Dunn, Franklin, Miller & Young). Utility cases accounted for only 2% of the total causes filed, while motor carrier causes accounted for 29% of the workload. *Id.* at 11.

7. Some courts have failed to distinguish between the drilling and spacing order and the forced pooling order, referring to them indiscriminately. See *Ward v. Corporation Comm'n*, 501 P.2d 503, 507 (Okla. 1972); *Layton v. Pan Am. Petroleum Corp.*, 383 P.2d 624, 625-26 (Okla. 1963).

westward in their search for petroleum, discovering a considerable number of shallow oil pools in Oklahoma Territory prior to statehood.⁸ When the Glenn Pool was discovered near Sapulpa in 1905, it was the first major oil field to be discovered in Oklahoma.⁹ At that time, oil production greatly exceeded market demand, and producers had difficulty marketing such oil.¹⁰ By the time the Glenn Pool was discovered, a legal concept known as the "rule of capture" had evolved in Oklahoma and other states regarding oil and gas production. The rule of capture required a mineral owner or lessee to reduce oil and gas to his possession in order to acquire title to it.¹¹ The concept evolved from the law relating to the capture of wild animals or game, as ownership by the hunter was not effective until the animal itself was "captured."¹² The rule of capture encouraged the drilling of numerous wells in a pool or field to maximize production, regardless of the effect excessive drilling had on the ultimate recovery of hydrocarbons.

In the period following discovery of the Glenn Pool, the marketing of these excessive quantities of oil proved difficult due to the limited capacity of existing oil pipelines.¹³ Integrated companies owning pipelines were the only parties who could transport their production to a ready market.¹⁴ Less fortunate developers often stored their excess production in earthen ponds, where evaporation, fire, or seepage would claim a major share. Those parties without an outlet or pipeline to market their oil watched helplessly as oil from under their land was "captured" and sold, vesting ownership in some other party.¹⁵ Experts noted that, due to excesses incurred under the rule of capture, "more oil has run down the creeks from the famous Glenn Pool than was ever produced in Illinois."'¹⁶

Because of the resulting waste, the Oklahoma Territory Legislature in 1905 passed an act regulating oil and gas drilling and production.¹⁷

8. 1 R. BOND, R. WEEMS & R. JONES, OKLAHOMA OIL & GAS CONSERVATION LAWS 213 (1950).

9. *Id.*

10. *Id.* at 214-15.

11. H. WILLIAMS & C. MEYERS, OIL AND GAS TERMS 782 (6th ed. 1984); 38 AM. JUR. 2D *Gas and Oil* § 5 (1968); see *Rich v. Doneghey*, 71 Okla. 204, 206, 177 P. 86, 89 (1918).

12. See *Rich*, 71 Okla. at 206, 177 P. at 89 (the right to explore for oil under a lease is analogous to a profit to hunt and fish on the land of another).

13. 1 R. BOND, R. WEEMS & R. JONES, *supra* note 8, at 214.

14. *Id.*

15. *Id.*

16. *Id.* at 215.

17. See *id.*

This act required that a producer plug abandoned wells, shut-in gas wells without a market,¹⁸ and protect water supplies by casing-off water-bearing formations.¹⁹ Before statehood, however, no agency existed to enforce the provisions of the act, and it was of little effect in reducing wasteful practices.²⁰

B. *Legislative and Constitutional Provisions*

The Oklahoma Corporation Commission is unique as a state regulatory agency because it was created at statehood in 1907 by provision of the state constitution.²¹ Originally, the main objective of the Commission was to regulate the monopolistic practices of railroads and telegraph lines in the new state. The Oklahoma Constitution and the provisions establishing the Commission were drafted at a time when many railroads were unpopular due to their high rates, abusive practices, and disregard for the public interest. As a result, the constitution granted the Commission extensive regulatory powers to assert public control over these problems. Due to the extensive powers delegated to the Commission and the public distrust of other powerful entities existing in the early 1900's, the constitution included safeguards to ensure that the Commission would be held accountable to the citizens of the newly formed state.

The first protection imposed by the constitution is that commissioners be elected in a statewide ballot, with each of the commissioners serving a staggered six-year term.²² The commissioners must be resident citizens of the state for two years preceding the election and may be no less than thirty years of age.²³ Furthermore, they may have neither a direct nor an indirect interest in any railroad, telegraph line, or other regulated entity.²⁴ Second, the constitution allowed the legislature to "alter, amend, revise or repeal" certain sections of the Oklahoma Constitution granting and defining the Commission's powers without the neces-

18. At this time essentially all drilling was undertaken in the hope of obtaining oil production, as no significant markets existed for natural gas. As a result of the lack of market, a gas well was considered by most producers to be no better than a dry hole. In 1931, the first major interstate natural gas pipeline was constructed from the mid-continent area to Chicago, and this pipeline increased the demand and desirability of drilling for natural gas.

19. See 1 R. BOND, R. WEEMS & R. JONES, *supra* note 8, at 215.

20. *Id.* at 215-16.

21. See OKLA. CONST. art. IX, §§ 15-35. The provisions of the Oklahoma Constitution establishing the Commission were adopted in large part from the Constitution of Virginia, which had earlier established a similar agency. See *St. Louis-San Francisco Ry. v. State*, 81 Okla. 298, 300-01, 198 P. 73, 75-76 (1921).

22. OKLA. CONST. art. IX, § 15.

23. *Id.* § 16.

24. *Id.*

sity of a formal constitutional amendment.²⁵ The legislature could treat these sections of the constitution as statutory law and amend them at any time through the legislative process. Thus, the legislature possessed the power to deal immediately with any matter requiring a prompt response. Commission jurisdiction over natural gas companies and pipelines, as granted by the state constitution, is one of the powers which can be amended legislatively,²⁶ but jurisdiction over oil pipelines cannot be so amended.²⁷

The constitution sets out the extent of jurisdiction, power, and responsibility which can be assumed by the Commission. These powers include the supervision, regulation, and control of all transportation and transmission companies doing business in the state,²⁸ such additional powers and duties as may be prescribed by law,²⁹ and the regulation of public utilities and public service corporations.³⁰

The Commission has been granted legislative, administrative, and quasi-judicial powers, yet it is a tribunal of limited jurisdiction having powers only to the extent conferred upon it by the constitution and statutes of the state.³¹ These constitutional and statutory provisions grant the Commission the power to establish rules and regulations governing the oil and gas industry and the power and authority of a court of record to enforce its lawful orders, including the ability to hold disrespectful or disorderly parties in contempt.³² The Commission is expressly exempt from the provisions of the state's Administrative Procedure Act,³³ except for those provisions which require it to file its rules and regulations with the Secretary of State.³⁴

In 1907, the first Oklahoma Legislature enacted a bill which regulated the construction, maintenance, inspection, and operation of natural

25. *Id.* § 35. This section allows the legislature to treat sections 18 through 34 of article nine as statutory law. *Id.*

26. *Id.* § 34.

27. Jurisdiction over oil pipelines is located in OKLA. CONST. art. IX, § 4.

28. OKLA. CONST. art. IX, § 18.

29. *Id.* § 19.

30. *Id.* § 24.

31. *Patterson v. Stanolind Oil & Gas Co.*, 182 Okla. 155, 161, 77 P.2d 83, 90-91 (1938), *appeal dismissed*, 305 U.S. 376 (1939); *see Oklahoma Gas & Elec. Co. v. Corporation Comm'n*, 543 P.2d 546 (Okla. 1975); *Merritt v. Corporation Comm'n*, 438 P.2d 495 (Okla. 1968).

32. OKLA. CONST. art. IX, § 19; *see Halpin v. Corporation Comm'n*, 575 P.2d 109 (Okla. 1977).

33. OKLA. STAT. tit. 75, § 301(1)(c) (Supp. 1985).

34. *Id.*; *see id.* § 304 (1981).

gas pipelines and established eminent domain procedures.³⁵ It provided that a corporation formed to transport natural gas would not be granted the right to eminent domain or the right to use state highways unless its gas was to be transported and used within the state at pipeline pressure less than three hundred pounds per square inch.³⁶ The Legislature's purpose was to retain all gas produced in Oklahoma for intrastate consumption, thus enhancing development of the industry. Pipeline companies were expressly prohibited from delivering natural gas to points outside Oklahoma and were subject to forfeiture of their property as a penalty. On review by the Supreme Court, however, portions of this statute were held to violate the commerce clause of the Constitution.³⁷

In response to the concerns of smaller producers unable to market their oil, the state legislature in 1909 enacted the Pipelines Act,³⁸ which expanded the Commission's authority over oil pipelines and operators of oil wells.³⁹ This Act generally provided for the ratable taking of oil, addressed the waste of natural gas, and regulated natural gas pipelines. The Act specifically provided that carriers of crude oil who also engaged in purchasing were common purchasers of the oil.⁴⁰ The first statute of its kind to be passed by any state, the Pipelines Act was an attempt to grant nonintegrated producers relief in marketing their oil.⁴¹

In 1913, the Oklahoma Legislature enacted the Production and Transportation Act,⁴² which expanded the Commission's jurisdiction over gas pipelines, defined natural gas transporters as common carriers, and provided for the ratable taking of natural gas.⁴³ This Act also provided that neither producers nor carriers of natural gas through pipelines should be allowed to take more than twenty-five percent of the daily natural flow of any gas well.⁴⁴ This requirement or limitation on production was recently changed by the legislature to allow wells to produce at fifty percent of their potential open flow capacity.⁴⁵

35. OKLA. COMP. LAWS ch. 75, art. 1, §§ 4809-4819 (1909). Portions of these statutes are now located at OKLA. STAT. tit. 52, §§ 1-17 (1981).

36. OKLA. COMP. LAWS ch. 75, art. 1, § 4815 (1909).

37. *West v. Kansas Natural Gas Co.*, 221 U.S. 229 (1911).

38. OKLA. COMP. LAWS ch. 75, art. 1, §§ 4820-4831 (1909). Portions of the provisions of the 1909 Act are now located at OKLA. STAT. tit. 52, §§ 51-65 (1981).

39. OKLA. COMP. LAWS ch. 75, art. 1, § 4820 (1909).

40. *Id.* § 4822.

41. 1 R. BOND, R. WEEMS & R. JONES, *supra* note 8, at 216-17.

42. 1913 Okla. Sess. Laws 166-74.

43. *Id.*

44. *Id.* at 171-72.

45. OKLA. STAT. tit. 52, § 29 (1981).

In the early years of the Commission, railroad regulation dominated its regulatory activity. In the period from 1907 to 1910, over ninety percent of the controversies before the Commission involved railways, express companies, and street car lines.⁴⁶ By the 1920's, however, much of the state regulation of railroad activity was preempted by federal regulatory activity.⁴⁷ As time progressed, regulation of oil and gas became an ever larger and more important part of the Commission's workload. In addition to regulating the oil and gas industry, the Commission has been given the responsibility of regulating other areas, including energy conservation, fuel inspection, public utilities, and transportation.⁴⁸ At the present time, however, the majority of the Commission's resources are dedicated to the regulation of oil and gas.⁴⁹

As the Commission became involved in oil and gas regulation, it became clear that some modification to the rule of capture was necessary to prevent economic waste and the loss of valuable hydrocarbons caused by the drilling of unnecessary wells. The device which ultimately modified the rule of capture, the drilling and spacing unit, has an interesting history in Oklahoma.

II. DRILLING AND SPACING UNITS

A. *Purpose of the Spacing Unit*

Drilling and spacing units, a common element of conservation legislation in many oil producing states, are established to control well density in a common source of supply. In Oklahoma, the mineral owner does not possess title to oil and gas in place. To obtain title, the mineral owner or his lessee must reduce the oil or gas to his possession.⁵⁰ This principle, the rule of capture, encourages the drilling of numerous unnecessary wells either to prevent drainage or to drain and capture oil from offsetting lands.

In the early years of oil and gas development, the rule of capture led to the drilling of numerous wells side by side in a common reservoir, causing a waste of hydrocarbons and the economic loss which follows the

46. Merrill, *Fifty Years of Public Law in Oklahoma*, 10 OKLA. L. REV. 375, 376 (1957).

47. *Id.* at 377.

48. See OKLAHOMA SENATE COMMITTEE, *supra* note 6, at 17.

49. Because of the predominance of oil and gas regulation, some parties have suggested the establishment of a separate commission to regulate oil and gas matters exclusively, leaving the Corporation Commission with the duty to regulate the utility and transportation sectors. At the present time, legislative proposals to accomplish this objective have not been introduced or adopted.

50. *Greenshields v. Warren Petroleum Corp.*, 248 F.2d 61, 67 (10th Cir.), *cert. denied*, 355 U.S. 907 (1957); *Ohio Oil Co. v. Sharp*, 135 F.2d 303, 307 (10th Cir. 1943).

drilling of unnecessary wells.⁵¹ Legislation providing for the creation of drilling and spacing units attempted to avoid the "drilling races" which occurred as a result of this rule.⁵² Under the rule of capture, wells would produce at full capacity to maximize revenues and cash flow, but in a short time would cease to flow due to the dissipation of reservoir energy.⁵³ It has been estimated that such practices left approximately eighty-five percent of the oil in the ground unrecovered.⁵⁴ The capital quickly acquired by the operator in this manner was more than likely put into other wells and ultimately dissipated.

Conservation laws enacted to limit production and drilling activity are credited by some authorities with keeping many developers in the oil and gas exploration business.⁵⁵ These conservation laws encouraged bankers to begin financing oil and gas exploration. Without regulation, petroleum reserves were quickly depleted or offset by additional wells in the same reservoir, but production and drilling restrictions effectively reduced the risks of lending on such reserves. Lending on producing properties, known as "production loans," is now a common method of financing in the oil and gas industry.

In short, the main purpose of creating drilling and spacing units is to permit a more effective recovery of hydrocarbons from a common source of supply.⁵⁶ The development of the drilling and spacing unit in Oklahoma occurred only after it was apparent that the rule of capture was not encouraging the effective development of Oklahoma's oil and gas resources.

B. *History of the Spacing Unit in Oklahoma*

The first well spacing rule promulgated in the United States was passed by the Railroad Commission of Texas in 1919. Rule 37 provided for two-acre spacing between oil wells by requiring that a well be drilled a minimum distance from the lease or property line.⁵⁷ The distances have been altered by the Railroad Commission periodically, and, since 1962, regulations in Texas have generally provided for forty-acre spacing

51. Dancy & Dancy, *Establishing Drilling and Spacing Units in Oklahoma—Is Publication Notice Sufficient?*, 55 OKLA. B.J. 2674, 2674 (1984).

52. *Panhandle Eastern Pipe Line Co. v. Corporation Comm'n*, 285 P.2d 847, 852 (Okla. 1955).

53. 1 R. MYERS, *THE LAW OF POOLING AND UNITIZATION* § 1.01(3), at 6-7 (2d ed. 1967).

54. *Id.*

55. *Id.*

56. Kuntz, *Statutory Well Spacing and Drilling Units*, 31 OKLA. L. REV. 344, 344-46 (1978).

57. H. WILLIAMS & C. MEYERS, *supra* note 11, at 785.

for oil wells.⁵⁸

The concept of the regulation of well density was introduced to Oklahoma in May 1929 by an Oklahoma City ordinance which confined drilling to certain areas inside the city limits and allowed only one well to be drilled on a "drilling block."⁵⁹ In order to drill on a drilling block, fifty-one percent or more of the owners or lessees needed to support the application requesting a permit to drill.⁶⁰ This ordinance was enacted after the Oklahoma City oil field was discovered in the mid-1920's when every lot owner wanted to drill a well to "capture" the oil for himself.⁶¹ Such haphazard development resulted in oil storage tanks in alleys, mud pits on school grounds, and dangerous equipment being used or stored in residential neighborhoods.⁶²

Realizing the need to limit waste under the rule of capture, the legislature considered a variety of regulatory schemes designed to prevent drilling races. Since the Oklahoma City ordinance addressing this problem had been upheld as constitutional, the legislature enacted the Well Spacing Act⁶³ in 1935, patterning it after the city ordinance. This Act was the state's first law directly empowering the Commission to create drilling and spacing units.⁶⁴ Prior to this time, the Commission had generally tried to promote conservation by using proration orders limiting production from given wells.⁶⁵ The Commission had enacted a few spacing orders under its broad powers to prevent waste prior to the Well Spacing Act, but the power had not been widely used.⁶⁶

58. *Id.*

59. Walker, *Recent Developments in Pooling and Unitization*, 6 INST. ON OIL & GAS L. & TAX'N 47, 72 (1955); see also *Phillips Petroleum Co. v. Davis*, 194 Okla. 84, 86, 147 P.2d 135, 137 (1942). A drilling block is defined as:

'[A] tract of land which has for its exterior boundary lines public streets, United States government lot lines, the channels of streams, the corporate limits of the city of Oklahoma City, railway right of ways or unplotted tracts of land, provided that in unplotted tracts the term "block" shall mean one contiguous tract of not less than five (5) acres.'

194 Okla. at 95, 147 P.2d at 145 (quoting city ordinance).

60. See *Amis v. Bryan Petroleum Corp.*, 185 Okla. 206, 207, 90 P.2d 936, 939 (1939).

61. The Oklahoma City ordinance was modeled after an ordinance enacted two years earlier by the city of Oxford, Kansas, which had experienced a similar problem regarding development after an oil field was discovered under that city. See *Marrs v. City of Oxford*, 32 F.2d 134 (8th Cir. 1929). To prevent the hazards that are associated with drilling in residential and developed areas, the Oxford ordinance attempted to limit the drilling to one well per city block and required the developing parties to post a bond prior to commencing drilling activities. See *id.* at 135.

62. H. WILLIAMSON, R. ANDREANO, A. DAUM & G. KLOSE, *THE AMERICAN PETROLEUM INDUSTRY* 542 (1963) (footnote omitted).

63. 1935 Okla. Sess. Laws 232-36.

64. 1 R. BOND, R. WEEMS & R. JONES, *supra* note 8, at 323.

65. *Id.* at 325.

66. *Id.*

The 1935 Well Spacing Act provided that the drilling and spacing unit for oil would not exceed ten acres unless at least eighty percent of the lessees of record, representing at least eighty percent of the acreage, agreed to a larger unit. In no event would the unit size exceed forty acres.⁶⁷ This requirement for a dual majority, eighty percent in number and eighty percent of ownership, was inserted to protect minority interests.⁶⁸ Where an original spacing order was extended to adjacent tracts, the courts held that the percentage limitation did not apply.⁶⁹ The eighty percent approval figure provided by statute referred only to the "lessees" of record in the unit; the mineral owner or lessor was not allowed to vote on the size of the unit.⁷⁰ While spacing units were limited to forty acres for oil production, no provisions were included in the initial Well Spacing Act to limit the size of the spacing unit for gas production.

In addition to the percentage approval requirement, the 1935 Well Spacing Act contained several other unique features. First, a well had to be located in the center of the unit to maximize the probability that the well would drain the entire unit.⁷¹ This created problems when surface obstructions such as buildings or ponds made it difficult or impossible to locate the well in the unit's exact center. Under such circumstances, the operator was required to obtain permission from the Commission to move its well to a more suitable location.

Second, the 1935 Act also specified uniformity in the size and shape of the unit.⁷² Because the statute required the well to be drilled in the unit's center, this second requirement created problems if a party wanted to create a unit whose size did not easily conform to Oklahoma's rectangular survey system.⁷³ For example, a square drilling and spacing unit twenty acres in size would be difficult to establish under the rectangular survey system as a section cannot be regularly divided into square twenty-acre units uniform in size and shape. One early applicant sought to establish twenty-acre uniform triangular units with the well located in the center of the triangle.⁷⁴ The Oklahoma Supreme Court upheld the

67. 1935 Okla. Sess. Laws 233.

68. 1 R. BOND, R. WEEMS & R. JONES, *supra* note 8, at 324.

69. *In re Lovell-Crescent Field*, 198 Okla. 284, 287, 178 P.2d 876, 879 (1947).

70. *Croxton v. State*, 186 Okla. 249, 251, 97 P.2d 11, 14 (1939).

71. *See* 1 R. BOND, R. WEEMS & R. JONES, *supra* note 8, at 329.

72. *Id.* at 330.

73. All land within the original 13 colonies, together with parts of Kentucky, Tennessee, Ohio, Maine, and Vermont were described with the "metes and bounds" system, which identifies tracts from certain external boundaries or objects. *See* J. GRIMES, A TREATISE ON THE LAW OF SURVEYING AND BOUNDARIES § 116, at 121-23 (4th ed. 1976).

74. *See Croxton*, 186 Okla. at 250, 97 P.2d at 13.

establishment of the triangular units under the Act, stating that each well drilled on the spacing unit had an equal opportunity to recover the oil under the tract.⁷⁵

Third, the 1935 Act did not prohibit each cotenant in a unit from drilling a well, which could result in multiple wells in each spacing unit.⁷⁶ The Act did provide that the mineral owners shared in the one-eighth royalty from any production from a well drilled on the unit.⁷⁷ If two cotenants could not agree on a mode of development of the spacing unit, each cotenant could drill a well with the requirement that the drilling party account to the nonparticipating cotenant.⁷⁸ No method was available at that time to coerce the noncooperating cotenant to participate in the development of the unit.⁷⁹

When a well was drilled on a drilling and spacing unit, the nonparticipating cotenant received the market value of his proportionate share of the oil, less drilling, developing, extracting, and marketing expenses.⁸⁰ By not cooperating, an owner could obtain, to the detriment of the risk-bearing cotenants, a risk-free interest in any well drilled. Therefore, if a cotenant would not cooperate in the drilling of a well, the proposed well would often not be drilled. To address the uncooperative cotenant problem, "forced pooling" procedures were enacted by the Oklahoma Legislature in 1945.

By 1945, developers had begun to explore the deeper basins in the western part of the state. The expense involved in deep drilling made the maximum size forty-acre drilling and spacing units uneconomical for oil development. In response, the Legislature in 1945 amended the Well Spacing Act.⁸¹ The change provided that the Commission had jurisdiction to establish spacing units larger than ten acres upon proof that at least 66 2/3% of the lessees had consented.⁸² The Act also provided for a maximum of forty-acre spacing for oil wells less than 8000 feet in depth and provided that 160-acre units could be established for oil wells deeper than 8000 feet.⁸³ Mineral lessors claimed that the 1945 Act allowed the

75. *Id.*; see 1 R. BOND, R. WEEMS & R. JONES, *supra* note 8, at 324.

76. See 1 R. BOND, R. WEEMS & R. JONES, *supra* note 8, at 332.

77. *Id.*; Walker, *supra* note 59, at 76.

78. 1 R. BOND, R. WEEMS & R. JONES, *supra* note 8, at 332-33; Walker, *supra* note 59, at 76.

79. 1 R. BOND, R. WEEMS & R. JONES, *supra* note 8, at 332.

80. *Earp v. Mid-Continent Petroleum Corp.*, 167 Okla. 86, 87, 27 P.2d 855, 856 (1933) (following *Prairie Oil & Gas Co. v. Allen*, 2 F.2d 566 (8th Cir. 1924)).

81. OKLA. STAT. tit. 52, § 87 (Supp. 1945).

82. *Id.* § 87(c).

83. *Id.*

lessee to establish the size of the drilling and spacing unit by vote, without the Commission's guidance. After a number of hearings before the Commission in which mineral lessors objected to the relatively large size of some of the lessee's proposed units, the 1947 Legislature abandoned the 66 2/3% lessee approval provision and vested the exclusive authority to determine the proper size of the drilling and spacing units in the Commission.⁸⁴

The 1945 Act also addressed some of the other problems of the earlier Act. Language requiring uniformity was revised to allow units of "approximately" uniform size and shape,⁸⁵ thereby allowing rectangular units for those acreages which were not easily divisible into square units.⁸⁶ This removed the problem of determining ownership in triangular units, as much of the real estate platted or conveyed in Oklahoma is divided on rectangular or square tracts to conform with the land surveys. The triangular units would not correspond to these ownership divisions, and difficult calculations were required to determine ownership where the triangular unit included fractions of numerous tracts.⁸⁷ The rectangular spacing units currently established by the Commission for 20-, 80-, and 320-acre units provide that the units are either "laydown" (east-west oriented) or "stand-up" (north-south oriented).

The 1945 Act also added flexibility to the location of the well by providing that it need not be located in the exact center of the unit as long as the well pattern was approximately uniform.⁸⁸ If a party could not drill at a location due to surface obstructions, the Commission could allow an exception to the well location provided that the allowable was adjusted to protect the parties.⁸⁹

Finally, the 1945 Act allowed only one well to be drilled on the unit, absent special approval of the Commission for the drilling of additional wells.⁹⁰ To preserve the constitutionality of this restriction, the Act also provided that the rights of the parties could be adjusted under forced pooling provisions,⁹¹ the attributes of which will be discussed below.

The current Oklahoma spacing statute is a product of the original

84. See 1 R. BOND, R. WEEMS & R. JONES, *supra* note 8, at 328.

85. OKLA. STAT. tit. 52, § 87(a) (Supp. 1945).

86. See 1 R. BOND, R. WEEMS & R. JONES, *supra* note 8, at 330.

87. *Id.*

88. See *id.*

89. OKLA. STAT. tit. 52, § 87(b) (Supp. 1945); see 1 R. BOND, R. WEEMS & R. JONES, *supra* note 8, at 330-31.

90. OKLA. STAT. tit. 52, § 87(b) (Supp. 1945).

91. *Id.* § 87(d).

1935 Well Spacing Act. However, the provision has been and still is the subject of frequent change. A number of recent amendments have been made to the spacing statute, including the requirements that acreage outside of a drilling and spacing unit be released if not developed within a given time frame⁹² and that the lessor's entire royalty interest, rather than the historical one-eighth royalty, be pooled.⁹³

C. *Legal Effect of the Spacing Unit*

Under Oklahoma law, before the development of a drilling and spacing unit, two or more mineral owners having an undivided interest in the leasehold or its minerals are classified as cotenants.⁹⁴ A cotenancy or tenancy in common is a "joint estate in which there is a unity of possession, but separate and distinct titles."⁹⁵ It is well established that the relationship of cotenants or tenants in common is not a fiduciary relationship absent special considerations.⁹⁶

In general, the mineral owner as cotenant favors a small drilling and spacing unit, as small units place fewer administrative restrictions on development.⁹⁷ Lessees, on the other hand, generally favor larger units, as these place an administrative limit on what can be required of the lessee under a given lease for further development.⁹⁸ The lessee's investment in the development of the leasehold is thus limited to a certain extent by administrative regulations establishing well density. As a result of these conflicts, the Oklahoma Legislature has established limits on the size of the spacing units which can be created.⁹⁹ A recent study on the subject claims that, in general, the Commission has established many drilling and spacing units too large to maximize the ultimate recovery of oil and gas.¹⁰⁰ If correct, the study indicates that the size of these units tends to

92. Known as the statutory Pugh clause, this provision is located at OKLA. STAT. tit. 52, § 87.1(b) (Supp. 1985). For an excellent discussion of this provision, see Hunt, *Oil & Gas: Retroactive Application of Oklahoma's Statutory Pugh Clause?*, 53 OKLA. B.J. 487 (1982).

93. OKLA. STAT. tit. 52, § 87.1(e) (Supp. 1985).

94. See *Taylor v. Brindley*, 164 F.2d 235, 240 (10th Cir. 1947).

95. *Id.* at 240; see also 20 AM. JUR. 2D *Cotenancy and Joint Ownership* § 22 (1965).

96. *Taylor*, 164 F.2d at 240; *Singer v. Singer*, 634 P.2d 766, 771 n.11 (Okla. Ct. App. 1981).

97. Kuntz, *supra* note 56, at 345.

98. *Id.*

99. Section 87.1(c) provides that a gas well shall be spaced on a maximum of 640 acres plus ten percent tolerance, unless the governmental section contains more than 640 acres, in which case the unit may comprise the entire section. OKLA. STAT. tit. 52, § 87.1(c) (Supp. 1985). Oil well spacing is limited to a maximum of 40 acres when the common source of supply is less than 4000 feet below the surface and is limited to a maximum of 80 acres for common sources of supply between 4000 and 9990 feet below the surface. *Id.* § 87.1(d).

100. J. Hibdon & D. Huettner, *The Oklahoma Corporation Commission: A Report to the Private Enterprise Foundation* 38-40 (April 12, 1982).

favor the lessee and that increased density drilling or de-spacing may ultimately increase recovery depending on the specific geological situation.¹⁰¹

Under Oklahoma law, a cotenant mineral owner or lessee cannot exclude another cotenant from developing the jointly owned minerals, and the parties deal with one another at arms length.¹⁰² A developing cotenant must account to the other cotenants for their proportionate share of revenue from an oil and gas well, less the reasonable and necessary costs of development.¹⁰³ A nonparticipating lessee will not receive income from production until the developing cotenant has recovered the costs of drilling and development, operations, and marketing associated with the well.¹⁰⁴ The royalty owner will receive a non-cost-bearing share of production by statute, even if his lessee does not participate in the cost of development. A nonparticipating cotenant who owns an unleased mineral interest will by statute be entitled to one-eighth of the production as a royalty, free of costs incurred.¹⁰⁵ However, for the remaining seven-eighths interest, he will be treated as a lessee and will not receive income from a well drilled in the spacing unit until costs are recovered by the participating cotenants.¹⁰⁶

Under the modern spacing statute, only one well may be drilled and produced from a given formation per drilling and spacing unit unless an additional well is reasonably necessary to effectively and efficiently drain the common source of supply in the unit.¹⁰⁷ Once a producing well is located on a drilling and spacing unit, another cannot be drilled on that unit from the same productive formation unless the Commission issues an increased density order allowing an additional well.¹⁰⁸ Furthermore, because the statute permits only one well on a drilling and spacing unit, all of the owners in that unit must be given a chance to participate in the drilling of the well or in the royalty produced therefrom; if that opportunity is not provided, the spacing order will constitute a taking of property

101. The number of increased density orders allowing the drilling of a second well on the unit increased from 379 in 1983 to 1006 in 1985, due in part to the fact that infill drilling is less risky and any gas discovered may already be dedicated to a gas contract, easily facilitating the sale of the gas in a period of overdeliverability.

102. *Moody v. Wagner*, 167 Okla. 99, 23 P.2d 633 (1933); *Singer v. Singer*, 634 P.2d 766 (Okla. Ct. App. 1981).

103. *Earp v. Mid-Continent Petroleum Corp.*, 167 Okla. 86, 89, 27 P.2d 855, 858 (1933).

104. *Barton v. Cleary Petroleum Corp.*, 566 P.2d 462, 464 (Okla. Ct. App. 1977).

105. OKLA. STAT. tit. 52, § 87.1(e) (Supp. 1985).

106. *Id.*; see *Barton*, 566 P.2d at 464.

107. OKLA. STAT. tit. 52, § 87.1(c) (Supp. 1985).

108. See *Layton v. Pan Am. Petroleum Corp.*, 383 P.2d 624 (Okla. 1963).

without due process.¹⁰⁹ The Commission has jurisdiction to enter a drilling and spacing order whether the lands in the drilling and spacing unit are leased or unleased,¹¹⁰ and the spacing of a leased mineral interest is not an unconstitutional infringement of the lessee's rights under the oil and gas lease.¹¹¹

Once the Commission has established a drilling and spacing unit, the royalty interest is by operation of law "pooled."¹¹² The lessor receives his royalty from any production of a well located in the spacing unit, whether or not the well is actually located on his particular lease.¹¹³ This royalty is free of all costs and expenses related to the development of the well.¹¹⁴

In *Shell Oil Co. v. Corporation Commission*¹¹⁵ (also known as the *Blanchard* decision), the Oklahoma Supreme Court held that each royalty owner in a drilling and spacing unit was entitled to a one-eighth royalty from any well producing on the spacing unit in the proportion that his acreage bore to the entire acreage in the unit.¹¹⁶ Any excess royalty above the one-eighth level which may have been granted in a lease was due and owing only if the royalty owner's lessee was actually selling oil or gas.¹¹⁷ This rule, unique to Oklahoma and known as the "Blanchardization" of the one-eighth royalty interest, applies whenever a drilling and spacing unit has been established. To comply with *Blanchard*, the operator of a gas well would often distribute the one-eighth royalty to all of the royalty owners in the spacing unit, and each individual lessee would be responsible for distributing the royalty burdens on its leases above the one-eighth level. As a result, many royalty owners who had negotiated a lease with, for example, a three-sixteenth royalty, would receive one check from the operator of their one-eighth royalty and another from their lessee for the remaining one-sixteenth royalty due on production from the unit well. Because this system frequently created confusion as to whether royalties had been properly paid, the Legislature in 1983 provided that certain information must be con-

109. *Ward v. Corporation Comm'n*, 501 P.2d 503, 507 (Okla. 1972).

110. *Barton*, 566 P.2d at 464 (citing *Sunray DX Oil Co. v. Cole*, 461 P.2d 305 (Okla. 1967), *cert. denied*, 396 U.S. 907 (1969)).

111. *See Layton*, 383 P.2d at 627.

112. *Petroleum Reserve Corp. v. Dierksen*, 623 P.2d 602, 605 (Okla. 1981) (citing *Whitaker v. Texaco, Inc.*, 283 F.2d 169, 172 (10th Cir. 1960)).

113. *Ward*, 501 P.2d at 507.

114. *Id.*

115. 389 P.2d 951 (Okla. 1963).

116. *Id.* at 954 (interpreting OKLA. STAT. tit. 52, § 87.1(d) (1961)).

117. *Id.* at 955.

tained on each check stub sent to royalty owners.¹¹⁸

Since a royalty owner under *Blanchard* was paid only for his excess royalty (that amount above the standard one-eighth royalty) if his lessee was actually selling gas discovered on the unit, it was important that the lessee market this natural gas. While most leases are silent as to a lessee's duty to market gas discovered in the leasehold, a duty to market has been implied.¹¹⁹

During the last few years, the natural gas market has been plagued by problems of excess supply, and many lessees have been unable to obtain contracts to sell their gas. Contracts that were negotiated were generally for a shorter duration than traditional long-term contracts or for a price much less favorable than contracts negotiated only a few years earlier.¹²⁰ As a result, many lessees were unable to sell their gas, and royalty owners did not receive their excess royalties unless their specific lessee was fortunate enough to have the expertise or size to negotiate a gas sales contract.

As a result of these problems, the Oklahoma Legislature recently enacted Senate Bill 160,¹²¹ which modified the statutes interpreted in the *Blanchard* decision. This bill made any party selling gas from a well in the unit responsible for all of the royalty due and owing from production to the extent of each royalty owner's interest.¹²² Under *Blanchard*, the party selling the gas was liable only to his own royalty owner for the extent of the royalty interest and was liable to the other royalty owners for only their one-eighth royalty.¹²³

In addition, Senate Bill 160 makes the first purchaser or purchasers jointly and severally liable to all royalty interest owners in the unit for payment of their share of the proceeds. Before this change, the first purchaser could enter into an arrangement with the operator of the unit which would allow the operator to distribute the proceeds, thus relieving

118. Each check should include lease or well identification, the month and year of sales, the total amount sold, the price at which the oil or gas was sold, severance taxes paid, the owner's interest in production, and other information. OKLA. STAT. tit. 52, § 568 (Supp. 1985).

119. *Tara Petroleum Corp. v. Hughey*, 630 P.2d 1269, 1273 (Okla. 1981); *Strange v. Hicks*, 78 Okla. 1, 4, 188 P. 347, 350 (1920).

120. The duty to market the gas includes the duty to obtain a fair price. In *Tara Petroleum*, the Oklahoma Supreme Court noted that a contract to sell natural gas should be "at a minimum fair and representative of other contracts negotiated at the time in the field." 630 P.2d at 1274. For a discussion of the duty to market, see Pearson & Dancy, *Negotiating and Renegotiating the Gas Contract: Producer Duties to Third Parties*, 56 OKLA. B.J. 2181 (1985).

121. S. 160, 40th Leg., 1st Sess., 1985 Okla. Sess. Laws 390 (codified at OKLA. STAT. tit. 52, §§ 540, 87.1(e) (Supp. 1985)). The significant amendments were to § 87.1(e).

122. OKLA. STAT. tit. 52, § 87.1(e) (Supp. 1985).

123. *Shell Oil*, 389 P.2d at 954-55. Compare OKLA. STAT. tit. 52, § 87.1(e) (Supp. 1985).

the purchaser of its liability.¹²⁴ As a result of this imposition of joint and several liability on the first purchaser and the uncertainty regarding the proper payment of owners in the unit, several parties have filed suit challenging the bill's constitutionality.¹²⁵ Furthermore, some pipelines and operators have suspended royalty payments until the uncertainty regarding this legislation has been resolved.

While addressing an important problem, Senate Bill 160 has also created problems regarding marketing of natural gas produced in Oklahoma. Under Senate Bill 160, if the first purchaser is an end-user to whom a direct sale is made, he may be jointly and severally liable for all royalty payments from the well. In some instances, an industrial plant or a farmer using natural gas for irrigation purposes as first purchaser could be jointly and severally liable for all royalty payments. Due to these potential liabilities, many end-users prefer to use natural gas produced in other states without such statutory provisions.

If Senate Bill 160 is determined to be constitutional, an issue also arises as to whether its provisions will be applicable to leases negotiated and executed prior to the effective date of the bill.¹²⁶ If its provisions only apply to spacing units and leases in spacing units negotiated subsequent to the effective date of the legislation, then the *Blanchard* rule would continue to apply to the majority of spacing units and productive wells in Oklahoma. Under a recent Oklahoma Supreme Court case dealing with the retroactive or prospective application of another legislative amendment to the spacing statute, the court noted that statutes are generally presumed to act prospectively unless the legislature expressly or impliedly intended retroactive application.¹²⁷ Furthermore, the court noted that, unless expressly intended by the legislature, a statute will not be applied retroactively if it alters rights and duties under an existing

124. Section 540 provides in part:

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.

OKLA. STAT. tit. 52, § 540 (Supp. 1985).

125. See, e.g., *Panhandle Eastern Pipe Line Co. v. Barby Energy Corp.*, CIV-86-0190E (W.D. Okla. 1986); *Panhandle Eastern Pipe Line Co. v. State ex rel. Comm'rs of the Land Office*, CIV-85-2659E (W.D. Okla. 1985).

126. The bill was effective as of October 18, 1985.

127. *Wickham v. Gulf Oil Corp.*, 623 P.2d 613, 615 (Okla. 1981). In *Wickham*, the court considered the retroactive or prospective application of an amendment creating the statutory Pugh clause in the spacing statutes.

contract.¹²⁸ Rights and duties have been created pursuant to oil and gas leases executed prior to the effective date of the bill. Because Senate Bill 160 does not contain language indicating that it should be applied retroactively, precedent indicates that it can only be applied prospectively. As a result, most spacing units should still be subject to the principles established by *Blanchard*.

Even though each unit may include numerous leases, only one well may be drilled or produced from a given formation in a drilling and spacing unit. Each lease may contain a habendum or term clause or other clauses requiring that a well be drilled and produced on the lease in order to hold the lease past its primary term. When there are numerous leases in the drilling and spacing unit, each requiring a well to be drilled on the lease to extend the lease past the primary term, difficulties may arise since only one well may be drilled to satisfy all the lease provisions. In general, a well drilled in the drilling and spacing unit will satisfy the terms of all the leases in the unit, even if the well is not located on a specific lease.¹²⁹

Prior to 1977, one well drilled in a drilling and spacing unit would extend the primary term of the leasehold located outside the drilling and spacing unit if the well was producing in paying quantities. In 1977, the Oklahoma Legislature enacted the statutory "Pugh" clause, which provides that "[i]n case of a spacing unit of one hundred sixty (160) acres or more, no oil and/or gas leasehold interest outside the spacing unit involved may be held by production from the spacing unit more than ninety (90) days beyond expiration of the primary term of the lease."¹³⁰ As such, a leasehold outside the spacing unit may be held past its primary term only temporarily by drilling or other activities in a unit 160 acres or more in size. This statute has been interpreted to operate prospectively only, thus limiting its application to leases taken after the effective date of the statute.¹³¹

D. *Police Power and the Ability to Space*

The power to establish drilling and spacing units is an attribute of

128. *Id.* at 616.

129. *Petroleum Reserve Corp. v. Dierksen*, 623 P.2d 602, 605 (Okla. 1981); *Layton v. Pan Am. Petroleum Corp.*, 383 P.2d 624, 626 (Okla. 1963); *State ex rel. Comm'rs of the Land Office v. Carter Oil Co.*, 336 P.2d 1086, 1093 (Okla. 1958).

130. OKLA. STAT. tit. 52, § 87.1(b) (Supp. 1985).

131. *Wickham*, 623 P.2d at 616 (applied statute prospectively from May 27, 1977).

the police power¹³² inherent in every sovereign state. The police power itself has been said to include "the power to make and enforce all wholesome and reasonable laws and regulations necessary to the maintenance, upbuilding, and advancement of the public weal."¹³³ The infliction of a loss on a specific individual due to police power regulation will not make that regulation invalid as all property is held subject to this power.¹³⁴ Regulations promulgated under the power are presumed valid unless subsequently proved otherwise, but the courts will not uphold regulations that are arbitrary and capricious.¹³⁵ The police power can be used to regulate private rights when a public interest may be protected or furthered.¹³⁶ In its early years, the Commission used the police power to actively regulate cotton gins, as well as the distribution, manufacture, and sale of ice, in the name of the "public interest." In more recent years, courts have generally upheld use of the police power to regulate oil and gas activities, including the establishment of drilling and spacing units.¹³⁷

Most leases include pooling clauses under which the lessee may voluntarily "pool" the leasehold acreage, creating in essence a voluntary spacing unit. A problem arises, however, when a voluntary unit created by this clause conflicts with a statutory drilling and spacing unit established by Commission order. The courts have generally held that private contractual rights established by a lease must yield to the Commission's authority to space under the police power.¹³⁸ To hold otherwise would allow the lessor to space the common source of supply by private contract without the authority or input of the Commission.¹³⁹ When construing lease clauses that conflict with Commission orders, the courts have generally held that the police power of the state is a part of the existing law at the time of the execution of the contract or lease and, as

132. *Patterson v. Stanolind Oil & Gas Co.*, 182 Okla. 155, 160, 77 P.2d 83, 89 (1938), *appeal dismissed*, 305 U.S. 376 (1939).

133. *Ex parte Tindall*, 102 Okla. 192, 198, 229 P. 125, 130 (1924).

134. *Marrs v. City of Oxford*, 32 F.2d 134, 139 (8th Cir. 1929).

135. *Croxton v. State*, 186 Okla. 249, 256, 97 P.2d 11, 18 (1939).

136. *See Russell v. Walker*, 160 Okla. 145, 148, 15 P.2d 114, 118 (1932).

137. *See C.C. Julian Oil & Royalties Co. v. Capshaw*, 145 Okla. 237, 240, 292 P. 841, 844 (1930).

138. *E.g., Hladik v. Lee*, 541 P.2d 196 (Okla. 1975). The court stated: "We conclude [that the] intent of [a] pooling clause was that any spacing unit established by [the] Corporation Commission would, insofar as it covered [the] same lands and formations, supercede a declared unit created pursuant to [a] pooling clause." *Id.* at 199; *see Nisbet v. Midwest Oil Corp.*, 451 P.2d 687, 696 (Okla. 1968).

139. *See Hladik*, 541 P.2d at 199-200.

such, becomes in contemplation of law a part of that contract.¹⁴⁰

E. *Requirements for Establishing the Spacing Unit*

The power to establish drilling and spacing units is granted by title 52, section 87.1(a) of the Oklahoma Statutes:

To prevent or to assist in preventing the various types of waste of oil or gas prohibited by statute, or any of said wastes, or to protect or assist in protecting the correlative rights of interested parties, the Corporation Commission, upon a proper application and notice given . . . and after a hearing as provided in said notice, shall have the power to establish well spacing and drilling units of specified and approximately uniform size and shape covering any common source of supply, or prospective common source of supply, of oil or gas within the state of Oklahoma¹⁴¹

Thus, before a drilling and spacing unit can be established, it must be shown that the proposed unit will cover a common source of supply and that it will either protect correlative rights or prevent waste.¹⁴² These two concepts lie at the heart of the regulation of oil and gas development.

The Oklahoma Supreme Court has stated that the doctrine of correlative rights "embraces the relative rights of owners in a common source of supply to take oil or gas by legal operations limited by duties to the other owners (1) not to injure the common source of supply and (2) not to take an undue proportion of the oil and gas."¹⁴³ The theory behind protecting correlative rights in effect provides each owner the right to take his equitable share of the oil and gas, providing he does not damage the common source of supply.¹⁴⁴

The prevention of waste, the other prerequisite to establishment of a unit, has been divided into two components: physical and economic waste.¹⁴⁵ Physical waste has been defined as an activity which may "unreasonably . . . diminish the quantity of oil or gas that might be recovered from a common source of supply."¹⁴⁶ An exact definition of economic waste is elusive, but when the drilling and spacing unit on a common source of supply was established in such a way that unnecessary

140. *Landowners, Oil, Gas & Royalty Owners v. Corporation Comm'n*, 420 P.2d 542, 544 (Okla. 1966) (citing *Oklahoma Natural Gas Co. v. Long*, 406 P.2d 499, 504 (1965)).

141. OKLA. STAT. tit. 52, § 87.1(a) (Supp. 1985).

142. *Id.*

143. *Kingwood Oil Co. v. Hall-Jones Oil Corp.*, 396 P.2d 510, 512 (Okla. 1964) (citation omitted).

144. See H. WILLIAMS & C. MEYERS, *supra* note 11, at 178-79.

145. *Id.* at 955; see also OKLA. STAT. tit. 52, §§ 86.2-86.3 (1981) (outlining the types of waste of oil and gas and specifying the Commission's authority to prevent it).

146. *Storck v. Cities Serv. Gas Co.*, 575 P.2d 1364, 1368 (1977) (citation omitted).

wells were needed to drain the reservoir, economic waste was found to have occurred.¹⁴⁷ Since the prevention of excessive drilling was a legislative consideration when enacting the spacing statute, such drilling seems to fall under the category of economic waste.¹⁴⁸

Not only must the establishment of a drilling and spacing unit prevent waste or protect correlative rights, but the unit must also overlay a "common source of supply, or prospective common source of supply, of oil or gas."¹⁴⁹ A "common source of supply" is statutorily defined as including "that area which is underlaid or which, from geological or other scientific data, or from drilling operations, or other evidence, appears to be underlaid, by a common accumulation of oil or gas or both"¹⁵⁰

Because geological data concerning the extent of a common source of supply are subject to different interpretations, the Commission reviews and interprets the evidence presented and enters an order in accordance with such evidence. Any doubt as to the interpretation of such data or the location of the drilling and spacing unit as established by Commission order should be resolved in favor of the Commission.¹⁵¹ The exact location of the common source of supply need not be delineated or defined by drilling operations before a drilling and spacing unit is established; geological interpretation of conditions will suffice.¹⁵² The common source of supply underlying the proposed drilling and spacing unit must be capable of producing oil and gas. The common source of supply by itself need not be productive enough to make the drilling of a well economically feasible; the fact that it contains hydrocarbons is sufficient to establish a drilling and spacing unit.¹⁵³

The modern statute has set the maximum size for the drilling and spacing unit for both oil and gas. For oil, the Commission may not es-

147. *Ward v. Corporation Comm'n*, 470 P.2d 993, 996 (Okla. 1970); see H. WILLIAMS & C. MEYERS, *supra* note 11, at 266.

148. See *Calvert Drilling Co. v. Corporation Comm'n*, 589 P.2d 1064, 1066 (Okla. 1979).

149. OKLA. STAT. tit. 52, § 87.1(a) (Supp. 1985); see *Cameron v. Corporation Comm'n*, 418 P.2d 932, 940 (Okla. 1966).

150. OKLA. STAT. tit. 52, § 86.1(e) (1981).

151. See *Calvert*, 589 P.2d at 1068-69 ("In order to secure a reversal of the spacing order on the grounds the Commission had no authority to space land not overlying the common source, the appellant must preclude the existence of a present or prospective common source.").

152. See *Vogel v. Corporation Comm'n*, 399 P.2d 474, 476 (Okla.), *cert. denied*, 382 U.S. 815 (1965).

153. See *Calvert*, 589 P.2d at 1066 ("Under applicable statutes, the applicant for a spacing order need not establish the whole area is underlaid by a formation productive enough to support a well which would be economic in its own right; it is sufficient that the formation probably contains oil and gas capable of being withdrawn by a well on the drilling and spacing unit.").

establish spacing units greater than forty acres covering common sources of supply less than 4000 feet below the surface and may not establish spacing units of more than eighty acres covering common sources of supply between 4000 and 9990 feet below the surface.¹⁵⁴ For gas, the drilling and spacing unit may not exceed 640 acres plus a ten percent tolerance for correction sections;¹⁵⁵ however, fractional sections along the state's boundary may include acreage which exceeds this statutory limit.¹⁵⁶

The difference in the unit size permitted for a gas or oil well stems from the fact that a gas well will generally drain a larger area due to the physical nature of the fluids. Since many wells produce both gas and oil, the Commission has defined an oil well as a well having a gas to oil ratio (GOR) of less than 10,000 cubic feet of gas to one barrel of oil. A gas well is defined as a well having a GOR of 15,000 cubic feet to one barrel or higher, and a well with a GOR between 10,000 and 15,000 can be classified as either a gas or oil well by the operator.¹⁵⁷ Although a well may originally be classified as an oil producer due to its low GOR, the GOR may increase until the well is technically classified as a gas producer. If a well changes in nature from an oil to a gas well, the size of the drilling and spacing unit may be changed to protect the correlative rights of the underlying mineral owners. In many instances, however, ownership differences may make it inequitable to change the size of the unit after the well has been drilled.¹⁵⁸

Because a spacing unit is generally established before drilling begins, disputes frequently arise with regard to the size of the unit. The Oklahoma Supreme Court has addressed this problem as follows:

No provision requiring a common source of supply to be exactly defined by drilling operations before a well-spacing or pooling order may be entered with reference to it, has yet been enacted by our Legislature. Perhaps, until some means other than drilling is devised to conclusively ascertain productivity, such a statutory provision would be desirable as more certainly precluding the owner whose interest may not be underlain by the spacing area's common source of supply, or the productive part of the producing sand or structure, from participating in its production. But this might, in many instances, defeat the purposes of well-spacing and pooling. Our Legislature has apparently thus far been persuaded that chancing the possibility of some owners

154. OKLA. STAT. tit. 52, § 87.1(d) (Supp. 1985).

155. *Id.* § 87.1(c).

156. *Id.*

157. Oklahoma Corporation Commission General Rules § 2-109.

158. *See* Landowners, Oil, Gas & Royalty Owners v. Corporation Comm'n, 415 P.2d 942 (Okla. 1966).

receiving benefits, to which subsequent explorations indicate they have not been entitled, is preferable to such a result. As the matter now stands, the lesser hazard is tolerated in preference to the greater hazard to the greater number of owners, and to the State in the dissipation of its natural resources by excessive drilling.¹⁵⁹

Where a unit is properly spaced for gas production and an oil well is produced as an exception to the general gas production in the field, the Oklahoma Supreme Court has held that the drilling and spacing unit need not be respaced to comply with the statutory provisions.¹⁶⁰

F. Notice and Hearing Requirements

Before an application to establish a drilling and spacing unit may be heard, state law requires at least fifteen days publication notice in a newspaper in Oklahoma City and in the county where the land is being spaced.¹⁶¹ No personal notice is required by statute unless the unit will encompass a well that is already drilling to or producing from the formation to be spaced.¹⁶² The Commission, as an administrative agency regulating natural resources under the police power, may not deprive a party of its property rights without notice if a hearing is required under the Constitution's due process clause.¹⁶³

The courts have recognized two kinds of protection under the due process clause: substantive due process and procedural due process.¹⁶⁴ As with the right to a fair hearing, the right to cross-examine witnesses, and the right to be represented by counsel, the right to adequate notice in a spacing hearing arises from the procedural branch of the due process clause.¹⁶⁵ Some agency functions do not require notice and a hearing, rendering procedural due process requirements inapplicable. Whether a hearing is required in a given situation depends upon the classification of the issues as adjudicative or legislative. In general, hearings are required

159. *Panhandle Eastern Pipe Line Co. v. Corporation Comm'n*, 285 P.2d 847, 853 (Okla. 1955).

160. *Meredith v. Corporation Comm'n*, 368 P.2d 828 (Okla. 1961).

161. OKLA. STAT. tit. 52, § 87.1(a) (Supp. 1985); Okla. Corp. Comm'n Rule of Practice (O.C.C.R.P.) 8-2(a); *see also* *Cravens v. Corporation Comm'n*, 613 P.2d 442, 443-44 (Okla. 1980) (referring to old designation of O.C.C.R.P. 12(b)), *cert. denied*, 450 U.S. 964 (1981).

162. OKLA. STAT. tit. 52, § 87.1(c) (Supp. 1985); O.C.C.R.P. 8-2(b). However, *Cotton Petroleum Corp. v. Harry R. Carlile Trust*, a recent Oklahoma Supreme Court decision, requires that personal notice must be given to mineral owners prior to the spacing of their royalty interests. No. 61,112, slip op. at 9-10 (Okla. Apr. 22, 1986). The court indicated that the decision is only to be applied prospectively. *Id.* at 17-18. Despite its impact on present notice requirements, the *Cotton Petroleum* decision is so far unpublished and thus may be subject to revision or withdrawal.

163. *See Cravens*, 613 P.2d at 444.

164. 1 A. RATHKOPF & D. RATHKOPF, *THE LAW OF ZONING AND PLANNING* § 4.02, at 4-3 (4th ed. 1985).

165. *See id.*

only for the determination of adjudicative issues.¹⁶⁶ Adjudicative issues involve specific matters directly affecting the interests of particular individuals in which the facts can best be developed by witnesses and cross-examination.¹⁶⁷ Legislative issues, on the other hand, involve general policies which are prospective in nature and which apply to numerous parties, making it impracticable to take testimony or allow cross-examination.¹⁶⁸ To make this distinction, the court must determine whether the action provides a general rule or policy which is applicable prospectively to an open class of individuals, interests, or situations or to specific individuals, interests, or situations.¹⁶⁹

If a hearing is required due to the adjudicatory nature of the proceeding, notice of the hearing must be reasonably calculated to inform the interested parties.¹⁷⁰ No simple formula specifies the kind of notice which must be given; the type of notice necessary to comply with constitutional requirements will vary with the circumstances.¹⁷¹ However, personal service of written notice is always adequate to meet due process requirements.¹⁷² This notice should adequately apprise the interested parties of the time, date, place, and purpose of the hearing.¹⁷³ If the notice is not adequately descriptive of the nature of the hearing, the notice may be deemed insufficient under the due process clause.¹⁷⁴ Courts have generally recognized publication notice as a poor substitute for actual notice¹⁷⁵ and have stated that, except by chance, publication rarely informs the owners concerning pending proceedings.¹⁷⁶ Publication notice is even less effective when the notice does not name the parties involved or when a party resides outside the newspaper's circulation area.

166. 2 AM. JUR. 2D *Administrative Law* § 403 (1962).

167. See *Londoner v. City & County of Denver*, 210 U.S. 373 (1908).

168. See *Bi-Metallic Inv. Co. v. State Bd. of Equalization*, 239 U.S. 441 (1915).

169. See Comment, *Zoning Amendments—The Product of Judicial or Quasi-Judicial Action*, 33 OHIO ST. L.J. 130, 137 (1972).

170. *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 314 (1950); see also *Bomford v. Socony Mobil Oil Co.*, 440 P.2d 713, 718 (Okla. 1968) (applying the rule of *Mullane*). In *Mullane*, the Supreme Court held that a trustee could not obtain a judicial settlement of its trust accounts if individual notice was not given to those beneficiaries whose addresses were known or easily ascertainable. 339 U.S. at 318. The Court noted that publication notice is appropriate "where it is not reasonably possible or practicable to give more adequate warning." *Id.* at 317.

171. See *Mullane*, 339 U.S. at 314; *Bomford*, 440 P.2d at 718.

172. *Mullane*, 339 U.S. at 313.

173. Cf. *id.* at 314.

174. Notice must be of such nature as reasonably to convey the required information and the nature of the proceeding. See 16A AM. JUR. 2D § 829 *Constitutional Law* (1979).

175. *City of New York v. New York, New Haven & Hartford R.R.*, 344 U.S. 293, 296 (1953).

176. See *Mullane*, 339 U.S. at 315.

However, when a vital state interest is involved¹⁷⁷ or when it is not reasonably practicable to give personal notice,¹⁷⁸ publication may be deemed sufficient.¹⁷⁹

The Oklahoma Supreme Court has expressly adopted the principles outlined in *Mullane v. Central Hanover Bank & Trust Co.*,¹⁸⁰ stating that the method of notification must be reasonably calculated to give a party notice in a meaningful time and manner of any proceeding directly affecting its property interest.¹⁸¹ For example, in *Cravens v. Corporation Commission*,¹⁸² a party had completed a producing gas well located on an eighty-acre drill site lease. Without notice to its owner, an offsetting leasehold owner filed an application with the Commission (later approved) to include this well in a 160-acre drilling and spacing unit.¹⁸³ On review, the Oklahoma Supreme Court held that the order establishing the 160-acre unit was void because the owner of the eighty-acre drill site lease was not personally notified of the application, therefore violating its due process rights.¹⁸⁴ The *Cravens* court expressly adopted the standards for publication enunciated by the Supreme Court in *Mullane*, stating that when the names and addresses of the parties having an interest in the well were easily ascertainable, publication notice would not suffice.¹⁸⁵

Oklahoma case law has established the general rule that personal notice is required when a well is already producing on the proposed spacing unit.¹⁸⁶ However, the fact remains that most spacing units are established prospectively—that is, before a well is drilled. When there are existing wells in the proposed spacing unit, the leasehold owners are in an adversarial relationship. The parties owning the rights surrounding a drill site lease will attempt to include their interests in a drill site spacing unit in order to share in production revenues without sharing the risk of drilling. Due to the adversarial disposition of the parties, the courts have correctly found that due process requires that all parties be personally

177. *Id.* at 313-14.

178. *Id.* at 317.

179. *Id.*

180. 339 U.S. 306 (1950); *see supra* note 170.

181. *Bomford*, 440 P.2d at 718.

182. 613 P.2d 442 (1980).

183. *Id.* at 443.

184. *Id.* at 444.

185. *Id.*; *see also* *Olansen v. Texaco Inc.*, 587 P.2d 976 (Okla. 1978) (where names and addresses of mineral owners in a field-wide unitization can be easily ascertained, they must be given actual notice of unitization hearing); *Louthan v. Amoco Production Co.*, 652 P.2d 308 (Okla. Ct. App. 1982) (order establishing unit held void as publication notice was deficient when participating parties' names and addresses were easily ascertainable).

186. *See Cravens*, 613 P.2d at 444.

notified of the proceedings.¹⁸⁷ When no wells exist in the proposed spacing unit, the leasehold owners will not be in an adversarial relationship, and the application to space will be more legislative than adjudicatory in nature.

The legislature has established a uniform policy to guide the Commission in establishing spacing units. The fact that these powers have been delegated to an agency does not alter the fundamental legislative character of the proceedings. When establishing spacing units, the Commission uniformly applies general policies and conservation principles in a prospective manner, involving numerous parties with an interest in the common source of supply. The Commission closely examines adjoining spacing units and, unless geological conditions warrant otherwise, requires uniformity in the size of the spacing unit overlying a formation to protect correlative rights. The Commission also has the power to prescribe the details connected with an act in order to carry the act into operation.¹⁸⁸

Consequently, well spacing may arguably be a legislative function, and personal notice may not be required due to the legislative nature of the proceeding. For example, zoning ordinances which are comprehensive and uniformly applied are generally considered legislative,¹⁸⁹ and publication notice concerning their establishment is usually held to satisfy due process requirements.¹⁹⁰ Use of the police power to define property rights under a zoning ordinance is arguably similar to the police power to establish oil and gas spacing units.

An argument can also be made that personal notice is not required when establishing spacing units because the owners or their addresses are not "easily ascertainable" under the *Mullane* standard.¹⁹¹ If an applicant is required to give personal notice to owners before establishing a spacing unit, he must first check all the deeds, mineral conveyances, and other instruments affecting ownership indexed against the property description to determine the ownership of the minerals. In most cases, the applicant would have to obtain a title opinion from an attorney covering the proposed spacing unit. The initial delay of obtaining a title opinion would slow the pace of activity and development, especially in town site areas.

187. *Id.*

188. See *Patterson v. Stanolind Oil & Gas Co.*, 182 Okla. 155, 77 P.2d 83 (1938); see also OKLA. STAT. tit. 52, § 86.4 (1981).

189. See *Garrett v. City of Oklahoma City*, 594 P.2d 764 (Okla. 1979).

190. Annot., 38 A.L.R.3d 167, 222-23 (1971).

191. 339 U.S. at 318; see *supra* note 170.

Once the identity of the owners is established from the county records, other records would likely have to be reviewed by a landman to determine the correct addresses of many of the parties. Unlike surface owners, whose addresses are easily ascertainable from the tax records, mineral owners are not assessed yearly taxes, hence their addresses may not be readily available from easily accessible records. Many mineral conveyances do not include addresses on the instrument, and, if they do, the addresses may not be current. Moreover, mineral interests may have passed to heirs through probate proceedings or may not be probated, again making the addresses of owners difficult, if not impossible, to ascertain. Because Oklahoma is a major producer of oil and gas, it is the rule rather than the exception that all or part of the minerals have been severed from the surface. Accordingly, notification of the severed mineral owners and lessees may require several hundred notices.

When personal notice is required by statute or judicial decision, state courts have generally held that "due diligence" must be exercised by the party searching the records for the addresses of the owners.¹⁹² What constitutes due diligence is a matter of judicial determination on a case-by-case basis. The Oklahoma Supreme Court has indicated that the following sources may have to be examined to meet the due diligence test: (1) local tax rolls, (2) deed records, (3) judicial and other official records, and (4) secondary sources such as telephone or city directories.¹⁹³ Should personal notice be required to establish a spacing unit, the Commission would have to establish standards to determine if the applicant's search was "diligent" and would also have to evaluate the notice or lack thereof on a case-by-case basis. It may be questioned whether addresses are "easily ascertainable" under the *Mullane* standard if the above sources must be examined in a diligent search for the owners.

The requirement that personal notice must be given may also place serious obstacles in the way of a state interest under the *Mullane* test.¹⁹⁴ Considering that the energy industry is a major employer in the state and that a seven percent tax is levied against all gross production, the state is obviously protecting a vital interest by promoting the development of oil and gas resources. Requiring personal notice under these circumstances could arguably impair that interest by wasting economic resources and slowing the rate of oil and gas development.

192. See *Bomford v. Socony Mobil Oil Co.*, 440 P.2d 713, 718 (Okla. 1968).

193. *Id.* Inquiries at the post office and public utility companies, as well as to former employers, neighbors, friends, and relatives have also been suggested.

194. 339 U.S. at 313-14.

G. *Modification of Spacing Orders*

In most cases, drilling and spacing units are established prospectively by Commission order before an oil and gas field or reservoir is completely developed. As a consequence, errors are sometimes made regarding the size, location, or prospective formations, thus requiring modification of the original drilling and spacing order. Because correlative rights vest under the original order, Oklahoma law provides that "[n]o collateral attack shall be allowed upon orders, rules and regulations of the Commission"¹⁹⁵ By statute, the sole method of appeal of a Commission order is to the Supreme Court of Oklahoma.¹⁹⁶

In order to modify a previous spacing order, a change in conditions or a change in the knowledge of conditions must be shown.¹⁹⁷ Three types of changes have been identified which allow the Commission to modify an order:

(1) A change in the physical behavior of the reservoir not predictable in the early stages of development;

(2) A change in the information gained about the reservoir obtained through further development activities;

(3) A change in the technology or scientific knowledge which may affect the definition of waste or the protection of correlative rights.¹⁹⁸ Knowledge gained from the further development of a field¹⁹⁹ or from changes in economic conditions relating to the development and production of oil and gas²⁰⁰ have been held to be sufficient changes of conditions to allow the Commission to modify a prior order. On the other hand, claims that an order was inequitable, unjust, and unconscionable did not constitute a change of condition and, therefore, were held to be collateral attacks on the previous spacing order.²⁰¹

III. FORCED POOLING ORDERS

A. *History of the Forced Pooling Order*

The Well Spacing Act of 1935 effectively provided for the establishment of drilling and spacing units which unitized or pooled the interest

195. OKLA. STAT. tit. 52, § 111 (1981); *see also* Harris, *Modification of Corporation Commission Orders Pertaining to a Common Source of Supply*, 11 OKLA. L. REV. 125, 131-34 (1958).

196. OKLA. STAT. tit. 52, § 111 (1981).

197. Harris, *supra* note 195, at 132.

198. *Id.* at 132-33.

199. *See* Marlin Oil Corp. v. Corporation Comm'n, 569 P.2d 961 (Okla. 1977).

200. *See* Kuykendall v. Corporation Comm'n, 634 P.2d 711 (Okla. 1981).

201. Wood Oil Co. v. Corporation Comm'n, 205 Okla. 534, 239 P.2d 1021 (1950).

of the lessors, but the lessees in the unit had no method to coerce a fellow cotenant into participating in the cost of drilling a well.²⁰² Unless the cotenants agreed on a plan of development for the unit, the developing cotenant was required to account to the other cotenants for their share of production less drilling, production, and marketing expenses.²⁰³ As a result, many units were not developed or development was delayed as cotenants negotiated and settled their disputes. Realizing this problem caused many delays in developing oil and gas properties, the legislature actively sought a solution which would encourage drilling and production activity in the units. In 1945, an act was passed which allowed a cotenant in a spacing unit to coerce the other cotenants into cooperating in the development of the unit.²⁰⁴ This act was modeled after an earlier Oklahoma City ordinance providing similar measures within the city limits.²⁰⁵ This ordinance, enacted in May 1929, limited the number of wells to be drilled in an area and required a permit before drilling.²⁰⁶ The ordinance established a spacing unit or "drilling block," and the owners of property within the unit had an option to participate either as cost-bearing or non-cost-bearing owners in a well.²⁰⁷

If a lessee chose to drill, but did not have the consent of all his cotenants, he could institute a proceeding before the Board of Adjustment to obtain the required drilling permit.²⁰⁸ The cotenants could either share proportionately in the production by paying in advance a portion of the estimated development costs or not share and receive a "fair and reasonable bonus" for their interest.²⁰⁹ Upon review, the Oklahoma Supreme Court upheld the ordinance as a valid exercise of the municipality's police power.²¹⁰

The legislature, realizing that the Oklahoma City ordinance had

202. See 1 R. BOND, R. WEEMS & R. JONES, *supra* note 8, at 332.

203. See *Meeker v. Denver Producing & Refining Co.*, 199 Okla. 455, 457, 188 P.2d 854, 856 (1947).

204. See 1945 Okla. Sess. Laws 339.

205. The provisions of this ordinance were adopted from an ordinance enacted in Oxford, Kansas providing for a similar means of development in that city. The Oxford ordinance provided that the owners in the block being developed could elect to participate in the costs of the drilling of a well on that block by making a written election to the City Clerk that they would participate in the cost of the well and by posting a bond for their share of the costs. A party not participating in the cost of drilling was entitled to a proportionate one-eighth royalty for its interest. See *Marrs v. City of Oxford*, 32 F.2d 134 (8th Cir. 1929).

206. See *Walker*, *supra* note 59, at 72.

207. *Id.* at 72-73.

208. *Id.* at 72.

209. *Id.* at 72-73.

210. See *Amis v. Bryan Petroleum Corp.*, 185 Okla. 206, 207, 90 P.2d 936, 938 (1939); *Cooke v. Westgate-Greenland Oil Co.*, 185 Okla. 209, 210, 90 P.2d 940, 941 (1939).

been ruled constitutional and was effective in regulating well density and promoting the development of oil and gas production, enacted compulsory pooling legislation.²¹¹ The 1945 Act allowed an applicant to "force pool" cotenant owners under proceedings and terms similar to those issued by the Board of Adjustment.²¹² Each cotenant had the option of participating in the cost of drilling or could lease or sell its interest.²¹³

The present forced pooling statute evolved from these early ordinances and statutes. When the parties cannot agree on a plan of development, it allows a cotenant to force pool other cotenants owning interests in the drilling and spacing unit.²¹⁴ Before a pooling order may be entered, however, the Commission must have previously established a drilling and spacing unit.²¹⁵ If the spacing unit is abrogated by Commission order, the accompanying pooling order may be rendered void and ineffective.²¹⁶

The forced pooling order covers only the common sources of supply designated in the unit. While several common sources of supply may be pooled under one order, only one spacing unit can be pooled per forced pooling order.²¹⁷ The forced pooling order supplements the spacing order by "pooling" the cotenants in the unit to the extent of their cost-bearing interest, as the statutory one-eighth royalty interest was pooled on the establishment of the spacing unit.²¹⁸

B. *Legal Effect of the Forced Pooling Order*

The forced pooling statute allows the owner-applicant to coerce cotenants into developing the drilling and spacing unit when the individual mineral or leasehold owners do not concur on a plan of development.²¹⁹ The courts have interpreted the statute to require an owner to possess the present right to drill in and produce from a unit in order to assert the

211. OKLA. STAT. tit. 52, § 87 (Supp. 1945).

212. *Id.*

213. *Id.*

214. OKLA. STAT. tit. 52, § 87.1(e) (Supp. 1985). It is interesting to note that during the first four months of 1948 only 11 applications were filed requesting forced pooling relief. *See* 1 R. BOND, R. WEEMS & R. JONES, *supra* note 8, at 334. During 1985, however, over 1,000 applications were filed during a similar period. Use of the forced pooling order has increased dramatically over the years, as 72 orders were issued in 1958, 1261 were issued in 1976, and 4206 were issued in 1982. Memorandum from Oil-Law Records Corp., Oil & Gas Orders Issued by the Oklahoma Corporation Commission (March 1983).

215. *See* Gulfstream Petroleum Corp. v. Layden, 632 P.2d 376, 379 (Okla. 1981).

216. *See* Southern Union Prod. Co. v. Eason Oil Co., 540 P.2d 603, 608 (Okla. Ct. App. 1975).

217. *See* Helmerich & Payne, Inc. v. Corporation Comm'n, 532 P.2d 419, 422 (Okla. 1975).

218. *See* Ward v. Corporation Comm'n, 501 P.2d 503, 507 (Okla. 1972).

219. OKLA. STAT. tit. 52, § 87.1(e) (Supp. 1985).

right to force pool.²²⁰ Thus, for example, an overriding royalty interest owner without the right to drill could not apply for a pooling order, nor would he be a proper party to a pooling order.²²¹ A voluntary agreement to develop a spacing unit is just as effective and binding on the parties as a forced pooling order.²²² In many cases, these voluntary agreements take the form of joint operating agreements, which have been standardized by the industry. Recent case law indicates that a voluntary agreement can supplement the terms of a forced pooling order.²²³ The order creates rights which vest at the end of an election period and which cannot be disturbed except as provided by statute.²²⁴ Although it has been challenged as unconstitutional, the forced pooling order has been held to be a valid exercise of the police power and does not deprive the mineral owner or lessee of any property rights.²²⁵

Drilling and spacing units may be established which overlay a number of different common sources of supply located at varying depths. If drilling and spacing units have been established for numerous common sources of supply, the forced pooling order can encompass all of the sources, eliminating the need for separate proceedings.²²⁶ This simplifies procedures when one well may penetrate several common sources of supply which may produce hydrocarbons. The forced pooling order does not require that a well be drilled, and an applicant cannot be bound inextricably to drill the well.²²⁷ Rather, the applicant merely proposes to drill a well and may later choose not to drill if conditions or circumstances do not warrant development.²²⁸

Owners subject to a forced pooling order will usually be given three options regarding their interests: (1) participating as a cost-bearing working interest owner; (2) selling or leasing their interest for a cash payment or bonus and/or overriding royalty interest; or (3) "farming out" for an overriding royalty interest.²²⁹ As long as the alternatives of-

220. See *May Petroleum, Inc. v. Corporation Comm'n*, 663 P.2d 716, 717 (Okla. 1982).

221. See *O'Neill v. American Quasar Petroleum Co.*, 617 P.2d 181, 184 (Okla. 1980).

222. OKLA. STAT. tit. 52, § 87.1(e) (Supp. 1985); see also *Petroleum Reserve Corp. v. Dierksen*, 623 P.2d 602, 605 (Okla. 1981).

223. *Tenneco Oil Co. v. El Paso Natural Gas Co.*, 687 P.2d 1049, 1054 (Okla. 1984).

224. *Crest Resources & Exploration Corp. v. Corporation Comm'n*, 617 P.2d 215, 218 (Okla. 1980); see also OKLA. STAT. tit. 52, § 111 (1981).

225. *Anderson v. Corporation Comm'n*, 327 P.2d 699, 702-03 (Okla. 1957), *appeal dismissed*, 358 U.S. 642 (1958).

226. See *C.F. Braun & Co. v. Corporation Comm'n*, 609 P.2d 1268, 1271 (Okla. 1980).

227. *Sellers v. Corporation Comm'n*, 624 P.2d 1061, 1063 (Okla. 1980).

228. *Id.* at 1063.

229. See *Ranola Oil Co. v. Corporation Comm'n*, 460 P.2d 415, 417 (Okla. 1969).

ferred are "just and reasonable" to the leasehold or mineral owner, the forced pooling order need not provide the standard three elections; only two alternatives will suffice.²³⁰

In earlier years, Commission pooling orders required nonparticipating parties to transfer an actual lease to the applicant for the bonus consideration provided in the pooling order.²³¹ When numerous zones were present, the lease would cover the pooled formation only.²³² After 1957, however, the forced pooling order and subsequent election to accept the bonus in lieu of participating in the costs have been deemed sufficient to effect the transfer of the pooled leasehold rights to the applicant.²³³

The spacing and pooling orders of the Commission need not be filed in the real estate records of the county in which the land is located. Therefore, a check of these county records by a landman or title attorney will not reveal whether the property has been spaced or force pooled. To determine if property has been spaced or pooled, a party must consult the Commission records or the records of a private company which keeps track of these orders.²³⁴ Several bills have been introduced in the legislature in recent years which would require that these orders be placed of record in the county where the land is located to afford notice that the minerals are subject to a forced pooling or spacing order. None of these proposals have become law. However, many attorneys advise their clients to put the forced pooling orders of record in the county where the land is located to put third parties on notice of the orders.

C. *Establishing Market Value*

In order to coerce cotenants into participating in the development of a well, the Commission must establish a fair market value to avoid depriving an owner of property without just compensation.²³⁵ To establish

230. *Id.* at 417.

231. Early Commission orders usually contained the language that "the leases shall be transferred to the applicant herein" in exchange for a bonus payment. *See, e.g.*, O.C.C. Cause C.D. No. 1937, Order No. 21,865 (Dec. 15, 1948); Cause C.D. No. 1485, Order No. 20,186 (July 16, 1947) (reprinted in 2 R. BOND, R. WEEMS & R. JONES, *supra* note 8, at 22-23, 324-25); *see also* Application of A.L. Huston, O.C.C. Cause No. 63,843, Order No. 243,274 (Aug. 10, 1983).

232. *See Wakefield v. State*, 306 P.2d 305, 306-07 (Okla. 1957).

233. There is nevertheless some question whether the applicant earns all of the rights which would be granted if a lease was transferred to the applicant under a forced pooling order. Questions remain as to what formations are earned under the order and whether the applicant earns only rights in the well bore or in the entire unit.

234. Oil-Law Records, a private corporation, can provide a "spacing abstract" detailing the spacing orders affecting a tract of land and the offsets to such tracts. Such information costs approximately \$100 per search.

235. *See Miller v. Corporation Comm'n*, 635 P.2d 1006, 1007 (Okla. 1981).

market value, the courts have said: "[T]he majority rule, adhered to in this State is that the value of land or interest in realty at a particular time may as a general rule be proved by evidence of voluntary sales of similar property in the vicinity made at or about the same time."²³⁶ In addition, the courts have held that leases recently taken in the open market in the area subject to the application are valid indicators of fair market value.²³⁷ In *Miller v. Corporation Commission*,²³⁸ the court further elaborated upon the concept of fair market value:

The measure of compensation for forcibly pooled minerals is their "fair market value"—the level at which this interest can be sold, on open-market negotiations, by an owner willing, but not obliged, to sell to a buyer willing, but not obliged, to buy. Evidence of comparable terms and prices previously paid for leases in the same area is relevant to, but not always conclusive of, the fair market value. Other factors may command or merit additional consideration.²³⁹

One measure that has not been held to represent fair market value is sale by condemnation.²⁴⁰ Similarly, by its very nature, the State of Oklahoma's sealed-bid process has been held not to accurately reflect market value.²⁴¹ Specifically, the sealed-bid process is incompatible with an open market sale because it "reflects the seller's unwillingness to bargain openly in, and yield to the forces of, the open market place."²⁴² While the sealed bid is not a sale on the open market and therefore not per se indicative of fair market value, the sealed-bid process may be considered if there is a nexus between the sealed-bid price and the fair market value.²⁴³

It has been argued that geological, economic, and engineering data should be reviewed to determine the fair market value of specific leasehold interests. In reviewing this claim, one court held that the present value of the leasehold as established by open market sales was sufficient to determine market value and that geological, engineering, and other studies of future market value were speculative, problematical, and conjectural and need not be considered in determining fair market value.²⁴⁴

236. *Coogan v. Arkla Exploration Co.*, 589 P.2d 1061, 1063 (Okla. 1979) (citation omitted).

237. *Id.* at 1062-63.

238. 635 P.2d 1006 (Okla. 1981).

239. *Id.* at 1008 (footnotes omitted).

240. See *Coogan*, 589 P.2d at 1063; *Durell v. Public Serv. Co.*, 174 Okla. 549, 552, 51 P.2d 517, 519-20 (1935).

241. *Miller*, 635 P.2d at 1008-09.

242. *Id.*

243. *Id.* at 1009.

244. *Home-Stake Royalty Corp. v. Corporation Comm'n*, 594 P.2d 1207, 1209-10 (Okla. 1979).

Under this reasoning, geological and seismic studies are proprietary information and may not be considered in establishing market value.

Leasehold values are usually set by the Commission by examining the fair market value for oil and gas leases taken in the area under similar circumstances at approximately the same time. Some parties have argued that the bonus consideration under a forced pooling order should be lower than the fair market value established by the sale of an oil and gas lease. Under a forced pooling application, the applicant generally only acquires an interest in the common sources of supply named in the forced pooling application, and an interest in formations which will not be penetrated will not be earned. In addition, the applicant may only acquire an interest in the zones completed as productive, and may only acquire an interest in the well bore being drilled, to the exclusion of future increased density wells. It should also be noted that the pooling order typically requires that an operator "commence" operations within a 180-day period, usually a time period shorter than the terms offered on an oil and gas lease. Because of these limitations, the rights obtained under a pooling order may not be as valuable as the rights obtained under the provisions of a standard oil and gas lease.

D. *Operator's Duties Under the Forced Pooling Order*

Under a forced pooling order, an operator is designated to take control of the managerial responsibilities of developing, producing, and selling the oil and gas.²⁴⁵ That power is a delegation of the state's police power under the conservation statutes and, once conferred, is nondelegable.²⁴⁶ The operator is free to subcontract for goods or services, but cannot transfer the managerial duties by private contract.²⁴⁷ The duty of the operator can only be transferred by the order of the Commission after notice and a hearing.²⁴⁸

By statute, the Commission's forced pooling order "shall make definite provisions for the payment of cost of the development and operation" and "shall be upon such terms and conditions as are just and reasonable and will afford to the owner of such tract in the unit the opportunity to recover or receive without unnecessary expense his just and

245. *Crest Resources & Exploration Corp. v. Corporation Comm'n*, 617 P.2d 215, 217 (Okla. 1980).

246. *Id.* at 217.

247. *Id.* at 218.

248. *Id.* at 217-18.

fair share of the oil and gas.”²⁴⁹ Thus the designated operator by statute has a duty to develop and operate the well without unnecessary expense. There have been very few cases addressing the concept of “operations” under a pooling order. One case has stated that the operator has a duty under the police power to operate to equitably apportion the oil and gas, as well as to equitably distribute the costs of production under a Commission order.²⁵⁰ In another case, the court indicated that “[t]he managerial responsibility of a designated unit operator in developing for, producing and selling oil or gas from the unitized pool is an exercise of the state police power.”²⁵¹

In the forced pooling process, the applicant will testify to the costs expected to be incurred in the drilling of a well. This estimate will be specifically incorporated into the order by the Commission and represents development costs to be paid by the working interest owners. In most instances, the cost estimate will not reflect actual expenditures and must be adjusted to reflect the actual cost of drilling a well.

The Commission retains primary jurisdiction to adjudicate any disputes concerning costs arising under a forced pooling order.²⁵² In *W.L. Kirkman, Inc. v. Oklahoma Corporation Commission*,²⁵³ the Oklahoma Court of Appeals stated that the Commission has the duty to determine whether the costs of development incurred by the operator were “both required and reasonable.”²⁵⁴ The *Kirkman* court emphasized that owners should be entitled to receive their share of oil and gas “without unnecessary expense” and noted that expenditures should not be “in excess of what are reasonable.”²⁵⁵ It is therefore implied that the operator has a duty to operate with the objective of minimizing costs or at least maintaining expenses at reasonable levels.

In determining cost, the Commission is a court of limited jurisdiction and therefore may not enter a money judgment against any party.²⁵⁶ If the Commission’s order determines the proper and reasonable cost of a well, the order will be upheld as valid and binding.²⁵⁷ While not a money

249. OKLA. STAT. tit. 52, § 87.1(e) (Supp. 1985).

250. *Wood Oil Co. v. Corporation Comm’n*, 205 Okla. 537, 239 P.2d 1023 (1950).

251. *Crest Resources*, 617 P.2d at 217 (footnote omitted).

252. *Id.* at 218.

253. 676 P.2d 283 (Okla. Ct. App. 1983).

254. *Id.* at 287 (emphasis omitted).

255. *Id.* (emphasis omitted).

256. *Lear Petroleum Corp. v. Seneca Oil Co.*, 590 P.2d 670, 672 (Okla. 1979); see *Stipe v. Theus*, 603 P.2d 347 (Okla. 1979).

257. *Lear*, 590 P.2d at 673-74.

judgment, the order can serve as the basis for establishing a money judgment against the working interest owner in district court.²⁵⁸

If a nonoperator elects to participate in the well but does not pay his share of the costs, the operator has a statutory lien on the nonoperator's share of production in the leasehold under the forced pooling order.²⁵⁹ If the well results in a dry hole, the operator's right to collect unpaid costs does not expire with the unit order, and the operator's lien remains effective against the leasehold estate.²⁶⁰

E. *Commission Powers over Federal Lands*

The police power is an attribute of sovereignty exercisable by the state over lands within its domain. Regarding the scope of this power over federal lands, the courts have observed that state law and state police power extend over the federal public domain within state boundaries until these powers are preempted in whole or in part by federal law.²⁶¹

The United States Constitution empowers Congress to regulate federal lands, providing in article IV, section 3 that "[t]he Congress shall have Power to dispose of and make all needful Rules and Regulations respecting the Territory or other Property belonging to the United States"²⁶² Congress can determine whether or not to exercise this power to preempt state conservation regulation.²⁶³ With regard to oil and gas leasing, Congress has prescribed limited, but not exclusive, control over the leasing of federal oil and gas pursuant to the Mineral Lands Leasing Act of 1920 and subsequent amendments to this legislation.²⁶⁴

When Congress has not acted, the law of the state will apply to the federal land; when Congress has not enacted exclusive controls, state regulation will also be permitted. When the Commission has entered orders affecting federal lands, the courts have held that two federal requirements must be satisfied before the state police power in the area of oil and gas conservation may attach to the federal lands. The first requirement is that a federal mineral lessee may not assign his lease without the ap-

258. See *Stipe*, 603 P.2d at 350.

259. OKLA. STAT. tit. 52, § 87.1(e) (Supp. 1985).

260. *Lear*, 590 P.2d at 673.

261. E.g., *Texas Oil & Gas Corp. v. Phillips Petroleum Co.*, 406 F.2d 1303 (10th Cir.), cert. denied, 396 U.S. 829 (1969). For an excellent discussion of this topic, see Comment, *Oil and Gas: The Effect of Oklahoma Conservation Laws On Federal and Indian Lands*, 29 OKLA. L. REV. 994 (1976).

262. U.S. CONST. art. IV, § 3.

263. *Kirkpatrick Oil & Gas Co. v. United States*, 675 F.2d 1122 (10th Cir. 1982).

264. See *id.* at 1124.

proval of the Secretary of the Interior.²⁶⁵ The second is that a pooling or communitization agreement involving federal and nonfederal lands must be approved by the Secretary to be effective.²⁶⁶

Due to these restrictions, a forced pooling order issued by a state agency such as the Commission is effective with regard to federal lands only if the order is approved by the federal government. A federal lease cannot be transferred, pooled, or otherwise unitized by operation of law under a forced pooling order. The United States Court of Appeals for the Tenth Circuit stated that "[i]f federal lessees are unable to secure the Secretary's approval for a voluntary communitization agreement, they should not be able to circumvent that requirement by obtaining a compulsory state pooling order."²⁶⁷

IV. CONCLUSION

The history of oil and gas development and exploration in Oklahoma clearly points to the need for effective regulation of the industry to prevent waste and to protect correlative rights, while at the same time promoting the development of the state's resources. Over time, various regulatory devices such as the drilling and spacing unit and the forced pooling order have proven effective in achieving this goal. Regulation by the Commission will continue to evolve in the state as oil and gas producing provinces continue to mature.

265. See *Texas Oil*, 406 F.2d at 1305.

266. *Id.*

267. *Kirkpatrick*, 675 F.2d at 1126 (citations omitted).