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Oil and Gas - Unitization - Conservation of Oil and Gas Resources - Greyhound Leasing & (and) Finance Corp. v. Joiner City Unit

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COMMENT

OIL AND GAS — UNITIZATION — Conservation of Oil and Gas Resources — *Greyhound Leasing & Finance Corp. v. Joiner City Unit*, 444 F.2d 439 (10th Cir. 1971).

INTRODUCTION

IN 1953, an oil well was drilled in Carter County, Oklahoma on a source measuring approximately 2 by 5½ miles and underlying 4,000 acres. Soon thereafter, numerous operators, including Greyhound Leasing's predecessor in interest,[1] began tapping the same source. In the ensuing years, as primary recovery[2] pressures were being depleted, the necessity of secondary recovery[3] operations became increasingly apparent. By 1961, some operators began advocating unitization,[4] and, with Greyhound's predecessor participating, they initiated engineering groundwork toward that goal. After negotiation, a unitization plan was adopted and filed with the Oklahoma Corporation Commission. In 1965, with approximately 95 wells producing by primary recovery from the common source, a hearing was conducted on the application. Greyhound Leasing insisted at the hearing that its two producing wells not be included in the unit, thereby maintaining the position their predecessor held in prior negotiations. The Commission consequently granted Greyhound's request, pursuant to a finding that secondary recovery by the unit would not adversely affect Greyhound Leasing.

In September 1965, shortly after approval of the unit,

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[1] Greyhound Leasing and Financial Corporation was the successor in interest, by merger, of Boothe Leasing Corporation.

[2] Primary recovery: "[T]he oil, gas, or oil and gas recovered by any method (natural flow or artificial lift) that may be employed to produce them through a bore; the fluid enters the well bore by the action of native reservoir energy or gravity." AMERICAN PETROLEUM INSTITUTE, SECONDARY RECOVERY OF OIL IN THE UNITED STATES 255 (1942).

[3] Secondary recovery: "Broadly defined, this term includes all methods of oil extraction in which energy sources extrinsic to the reservior are utilized in the extraction." Index Vol., H. WILLIAMS & C. MEYERS, OIL AND GAS LAW, Oil and Gas Terms 408 (1964). The method of secondary recovery used by Joiner City Unit was injection of salt water into the formation through an input well, oil being removed from surrounding wells.

[4] " 'Unitization,' or, as it is sometimes described, 'unit operation,' means the joint operation of all or some part of a producing reservoir. . . . The purpose of unitization is to permit the entire field (or a very substantial portion of it) to be operated as a single entity, without regard to surface boundary lines." 6 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 901 (1968).

Joiner City Unit began injecting water over a mile from Greyhound's nearest lease. Eleven months later, Greyhound brought suit in federal district court to recover damages incurred as a result of injected water having displaced the oil beneath its leases. The action was tried before a jury, and Greyhound was awarded $529,844.52 in damages.[5] On appeal to the Tenth Circuit Court, the lower court's decision was affirmed.

I. UNITIZATION IN OKLAHOMA

In a nation which literally runs on oil, proper conservation of the source of supply is of vital importance. As primary oil and gas recovery pressures are tapped to the economic limits of production, it is increasingly necessary to resort to the use of effective secondary recovery methods in order to obtain maximum oil recovery. To achieve this end, no fewer than 22 states,[6] including the vast majority of important oil and gas producing states, with the notable exception of Texas, have enacted statutes providing for compulsory unitization.

The Oklahoma statute, widely accepted as a model for other compulsory unitization statutes,[7] and perhaps the most comprehensive on the subject,[8] was designed to strike a fair balance between the protection of traditional property rights and the interests of conservation. Specifically, the statute was enacted to regulate oil production "to the end that a greater ultimate recovery of oil and gas may be had therefrom, waste prevented, and the correlative rights of the owners in a fuller and more beneficial enjoyment of the oil and gas rights, protected."[9]

Under Oklahoma law the Corporation Commission is charged with the regulation of all oil and gas production in the state. It has broad powers to "do such things as may be necessary or proper to carry out and effectuate the purposes

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[5] Damages were based on the difference between before and after recoverable reserves.

[6] Ala., Alas., Ariz., Ark., Cal., Colo., Fla., Ga., Kan., La., Mich., Miss., Mont., Neb., Nev., N.Y., N.D., Ohio, Okla., Ore., Utah, Wash. 6 H. WILLIAMS & C. MEYERS, *supra* note 4, § 912.

[7] *Id.* § 912.3 at 103.

[8] *Id.* § 912.3 at 102.

[9] OKLA. STAT. ANN. tit. 52, § 287.1 (1969). These same purposes are stated in COLO. REV. STAT. ANN. §§ 100-6-6,-22 (1963). Correlative rights: "The opportunity afforded, so far as it is practicable to do so, to the owner of each property in a pool too produce without waste his just and equitable share of the oil or gas, or both, in the pool . . . ." H. WILLIAMS & C. MEYERS, *supra* note 3, at 93.

of this Act."[10] In the exercise of its police power, the Commission may use the compulsory unitization provisions[11] of the statute for owners on a common source.[12] Broad scope is given the Commission to consider the fairest apportionment formula,[13] including the power to enlarge the unitized area and to amend the plan of unitization.[14] Specific provision also exists for appeal of any order of the Commission to the Oklahoma Supreme Court.[15]

The statute provides that any unit embracing less than the whole of the common source of supply can be permitted by the Commission:

> [O]nly where it is shown by the evidence that the area to be so included within the unit area is of such size and shape as may be reasonably required for the successful and efficient conduct of the unitized method or methods of operation for which the unit is created, *and that the conduct thereof will have no material adverse effect upon the remainder of such common source of supply.*[16]

In a situation where the non-joiner has knowledge that he is operating in the same pool with the unit and has had adequate opportunity to participate in the unit, several options are available to the courts. As the following discussion of each alternative will reveal, *no case law existed* prior to *Greyhound Leasing* directly on point to support any of the alternatives.

[10] OKLA. STAT. ANN. tit. 52, § 287.2 (1969). The Colorado counterpart states "The commission shall have jurisdiction and authority over all persons and property public and private necessary to enforce the provisions of this article and shall have the power and authority to . . . do whatever may reasonably be necessary to carry out the provisions of this article." COLO. REV. STAT. ANN. § 100-6-5(1) (1963).

[11] OKLA. STAT. ANN. tit. 52, § 287.4 (1969). In Colorado, COLO. REV. STAT. ANN. § 100-6-16(5) (Supp. 1965).

[12] Although none share the facts of *Greyhound Leasing*, numerous Oklahoma decisions have given effect to the Unitization Act, holding it to be a valid exercise of police power by the legislature and not violative of section 23, article 2 of the State's constitution. West Edmond Hunton Lime Unit v. Stanolind Oil & Gas Co., 193 F.2d 818, (10th Cir. 1951); Jones Oil Co. v. Corporation Comm'n, 382 P.2d 751 (Okla. 1963); Woody v. State Corp. Comm'n, 265 P.2d 1102 (Okla. 1954); Spiers v. Magnolia Petroleum Co., 206 Okla. 503, 244 P.2d 843 (1952); Palmer Oil Corp. v. Phillips Petroleum Corp., 204 Okla. 543, 231 P.2d 997 (1951).

[13] OKLA. STAT. ANN. tit. 52, § 287.4 (1969). In Colorado, COLO. REV. STAT. ANN. § 100-6-16(4)(d) (Supp. 1965).

[14] OKLA. STAT. ANN. tit. 52, § 287.10. This provision has been subsequently held constitutional. Spiers v. Magnolia Petroleum Co., 206 Okla. 503, 244 P.2d 843 (1952); Palmer Oil Corp. v. Phillips Petroleum Co., 204 Okla. 543, 231 P.2d 997 (1951). The Colorado statutory counterpart is COLO. REV. STAT. ANN. § 100-6-16(6) (Supp. 1965).

[15] OKLA. STAT. ANN. tit. 52, § 287.6 (1969). In Colorado, COLO. REV. STAT. ANN. § 100-6-11 (1963) calls for appeal to the district courts.

[16] OKLA. STAT. ANN. tit. 52, § 287.4 (1969) (emphasis added). The Colorado provision reads: "An order may provide for unit operations on less than the whole of a pool where the unit area is of such size and shape as may be reasonably required for that purpose, and the conduct thereof will have no adverse effect upon other portions of the pool. COLO. REV. STAT. ANN. § 100-6-16(8) (Supp. 1965).

Legislative intent and public policy considerations, however, loom large in deciding upon the proper solution.

II. THE DECISION IN GREYHOUND LEASING

The Tenth Circuit Court of Appeals limited itself to the consideration of only two alternatives by restricting its inquiry to two issues: (1) whether Oklahoma's modified private nuisance doctrine should have been applied; and (2) whether the Corporation Commission's order resulted in immunity from liability to Joiner City Unit.[17] The first question is framed so that an affirmative answer would give full effect to the protection of individual property rights while ignoring sound conservation practices. In contrast, an affirmative answer to the second question would give full scope to conservation interests while ignoring property rights.

In considering the issue respecting the applicability of the modified private nuisance doctrine, the court apparently viewed the Oklahoma constitutional provision providing that "[n]o private property shall be taken or damaged for private use . . . unless by consent of the owner" as being in conflict with the conservation provisions of the Unitization Act.[18] Oklahoma court interpretations of this constitutional provision have resulted in a strong flavor of strict liability in the application of the private nuisance doctrine. To interpret Oklahoma's application of this doctrine, the court in *Greyhound* relied heavily on *Gulf Oil Corp. v. Hughes*.[19] In *Gulf Oil* the defendant was held strictly liable for damages to plaintiff's *water* supply resulting from defendant's use of "water flooding" in secondary recovery of oil.[20] *Greyhound* also made brief reference to other

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[17] 444 F.2d 439, 441 (10th Cir. 1971).

[18] In view of the weight placed on this constitutional provision by the court, both the Oklahoma provision and its Colorado counterpart are quoted here in full for purposes of comparison.

OKLA. CONST. art. 2, § 23. "No private property shall be taken or damaged for private use, with or without compensation, unless by consent of the owner, except for private ways of necessity, or for drains and ditches across lands of others for agricultural, mining, or sanitary purposes, in such manner as may be prescribed by law."

COLO. CONST. art. 2, § 14. "Private property shall not be taken for private use unless by consent of the owner, except for private ways of necessity, and except for reservoirs, drains, flumes or ditches on or across the lands of others, for agriculture, mining, milling, domestic or sanitary purposes."

[19] 371 P.2d 81 (Okla. 1962).

[20] An earlier Oklahoma case, quoted by *Gulf Oil Corp.*, was Fairfax Oil Co. v. Bolinger, 186 Okla. 20, 97 P.2d 574 (1939). This was an action based on damages from vibrations resulting from defendant's oil drilling operation. The court held that, even though defendant's wells were worked on in a lawful manner and without negligence, the effect of section 23, article 2 of the constitution required that plaintiff recover as for a nuisance in fact.

Oklahoma cases considering the private nuisance doctrine,[21] but the court ended argument on the question by further reference to *Gulf Oil*:

> We must take the decisional law prevailing in Oklahoma to be as expressed in the opinion in *Gulf Oil Corp. v. Hughes* . . . . This rule should be applied to the somewhat different facts before us unless these differences provide some substantial reason to the contrary. *We find that differences do not provide such a reason.*[22]

Thus, the court held the modified nuisance doctrine applicable, and that salt water intrusion was a nuisance per se under state decisions.

It appears that the court stretched the rule of stare decisis by applying *Gulf Oil's* strict liability holding to the significantly different circumstances found in *Greyhound Leasing.* Since the injury was to a water supply, unitization legislation was immaterial to the facts of *Gulf Oil.* Under the facts of *Greyhound Leasing,* however, the unitization statute clearly requires that conservation interests be balanced with property rights. Previous Oklahoma decisions have found no conflict between this statute and constitutional private property protections.[23]

In considering the second issue of whether the Corporation Commission's order resulted in immunity to Joiner City Unit, the court gave a negative response to the argument urged by the defendants. Joiner City Unit argued that the Commissioner's order irrevocably fixed the rights of all parties on the common source allowing Greyhound Leasing no recovery. It was asserted that Greyhound Leasing was completely aware of the circumstances and had full opportunity to participate in the unit. The defense concluded that, by refusing to participate, Greyhound Leasing assumed the risk of remaining outside the unit and was therefore estopped from asserting any claim if the risk yielded unfavorable results.

The court acknowledged that the Commission specifically retained jurisdiction and admitted that the Commission's exer-

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[21] West Edmond Hunton Lime Unit v. Lillard, 265 P.2d 730 (Okla. 1954); West Edmond Salt Water Disposal Ass'n v. Rosecrans, 204 Okla. 9, 226 P.2d 965 (1950); Larkins-Warr Trust v. Watchorn Petroleum Co., 198 Okla. 12, 174 P.2d 589 (1946); British-American Oil Producing Co. v. McClain, 191 Okla. 40, 126 P.2d 530 (1942). Like *Gulf Oil Corp.* and *Fairfax Oil Co.*, however, none of these cases involved a contest over prevention of waste or correlative rights in a common source of supply as previously determined by the Corporation Commission. Rather, they were cases which were primarily exercises in the application of the state's private nuisance doctrine.

[22] 444 F.2d 439, 442 (10th Cir. 1971) (emphasis added).

[23] *See* cases cited note 12 *supra.*

cise of police power was valid under Oklahoma law.[24] The court also pointed out that no attempt had been made to compel plaintiff's participation in the unit, and that the Commission had approved unitization of all of a common source except for Greyhound's leases. The court then proceeded to explain that:

> [I]t does not follow that the Commission thereby somehow permitted the Unit operations on their authority to extend with the Commission's blessing to the portion not unitized as defendant infers. The tracts of plaintiff simply were not unitized nor reclassified, and this is clearly permitted under the statute. These tracts were thus in no different position relative to regulation than they were before the hearing.[25]

Despite the fact that Greyhound was on notice of the unit operation, it could have taken no precautionary measures to avoid the flooding of its wells and had every right to full enjoyment of property rights in the absence of the Commission's exercise of compulsory unitization provisions. Consequently, the court found no Joiner City Unit immunity as a result of the Commission's order. It also found no Oklahoma authority to *preclude* the hearing of a cause of action for damages by a court[26] and upheld the trial court's ruling that: "[A]s a *matter of law* . . . the plaintiff need not have resorted to administrative relief before the Oklahoma Corporation Commission before commencing the legal proceedings."[27]

The court's second question was framed so as to yield an all or nothing answer. Had the court chosen this alternative, holding Joiner City Unit "immune," a non-joiner's right to remain independent would be reduced to a gamble. To allow plaintiff no remedy in these circumstances would in effect coerce unitization in complete disregard for individual property rights.

On the other hand, the court, in finding no Joiner City Unit "immunity" and in denying further administrative action by holding Joiner City Unit strictly liable for its operation, serves to discourage would-be joiners from unit operation in complete disregard for conservation of oil resources. From a public policy standpoint, the long-range effect of this decision will not only be detrimental to conservation interests because of delays in unitization, but will be detrimental to the protection of property rights as well. Here the plaintiff is allowed

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[24] 444 F.2d 439, 443 (10th Cir. 1971).

[25] *Id.*

[26] *Id.*

[27] *Id.* at 441 (emphasis added).

to have his cake and eat it too. He may take the highly favorable risk that he will derive a benefit from water flooding operations of the unit (without sharing in the costs) with the assurance that, should his gamble fail, he may still recover any loss in court. Here the non-joiner's gamble is always to the detriment of the leaseholders of the unit who are not only operating in strict conformity with the law but are doing so in conformity with the directives of a government agency whose duty is to oversee such operations. This clearly avoids a proper accounting of the conservation interests found under the statute.[28]

III. An Alternative Solution

As already indicated, given the two basic purposes of protection of property rights and conservation interests, it is obvious that in an action concerning unit operation a court may chose between three alternatives. The court may (1) give overriding protection to property rights at the expense of sound conservation practices, (2) protect the interests of conservation at the expense of property rights, or (3) strike a balance between property rights and conservation interests.

The more viable alternative, and the only one giving proper recognition to both the prevention of waste *and* the full protection of individual property rights, is for the court to require the non-joiner to initially seek relief *before the Commission,* rather than before the court, for a reformation of the unit and a reapportionment of production profits, with a *right of appeal* to the state courts. In Oklahoma, this would presently require the state court to overturn *Greyhound Leasing's* interpretation of the statute, recognizing that the statute requires a rehearing of the matter before the Commission.[29] While case law on this point is virtually nonexistent, similar cases considered together seem to support this alternative.[30] Moreover, the provisions

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[28] *See* material cited note 9 *supra.*

[29] As a practical matter, to insure the obvious intent of the statute the state legislature should amend its Unitization Act to specifically cover this situation.

[30] In Tidewater Associated Oil Co. v. Stott, 159 F.2d 174 (5th Cir. 1947), the dispute was between lessor and lessee and consequently did not involve protection of correlative rights (*see* note 9 *supra*). However, the decision is reflective of the public policy against waste and the facts are so similar to *Greyhound Leasing* as to be of some guidance. Here defendant lessees participated in a unit recovering gas by injection of dry gas to force recovery of the more valuable wet gas. Certain lessors who had refused to join the unit brought suit against their lessees for failing to protect against the displacement of wet gas under their properties. The court found defendants not liable because the non-consenting lessors had been given an opportunity to participate in the unit. The more recent case of California Co. v. Britt, 247 Miss. 718, 154

of Oklahoma's Unitization Act seem to require this result,[31] despite the *Greyhound Leasing* interpretation.

The court correctly stated that since plaintiff's leases were not included in the unit, the tracts were in no different position relative to the regulation than they were before the hearing.[32] What the court failed to recognize was that once plaintiff's wells were flooded, the Commission's finding that the unit would not adversely affect other owners in the common source was no longer a valid assumption upon which to base the membership of the unit, and that further proceedings before the Commission were necessary to properly account for the changed circumstances.

Keeping in mind that the Commission has the power to enlarge the unit[33] and to do what is necessary to further the purposes of the Act,[34] it is submitted that the Commission has the power to include the plaintiff in the unit, assigning him his proportionate share of the income from the time his wells were flooded less his share of the secondary recovery costs. For those who would argue that this allows the plaintiff the same "have your cake and eat it too" advantage of the first alternative, the Commission could and should additionally charge plaintiff his pro rata share of secondary recovery costs *prior* to the flooding of his wells for any benefit the Commission finds plaintiff enjoyed at the unit's expense.

CONCLUSION

In 1965 more than 30 percent of the nation's total output of oil was produced by secondary recovery operations.[35] As the depletion of primary recovery pressures continues, the use of secondary recovery methods assumes ever-growing importance. Given the complicated nature of ownership rights to oil and gas it is obvious that adequate conservation measures may be

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So. 2d 144 (1963), concerned a dispute between cotenants with essentially the same fact pattern found in *Stott*. Here the court also found no liability because the plan had been approved by the conservation agency and plaintiff had been given an opportunity to join the unit.

[31] OKLA. STAT. ANN. tit. 52, §§ 287.1 to 287.15 (1969). The Colorado counterpart is the Oil and Gas Conservation Act, COLO. REV. STAT. ANN. §§ 100-6-1 to -22 (1963).

[32] 444 F.2d 439, 443 (10th Cir. 1971).

[33] OKLA. STAT. ANN. tit. 52, § 287.10 (1969); Spiers v. Magnolia Petroleum Co., 206 Okla. 503, 244 P.2d 843 (1952). In Colorado, COLO. REV. STAT. ANN. § 100-6-16(6) (Supp. 1965).

[34] OKLA. STAT. ANN. tit. 52, § 287.2 (1969). Colorado provisions quoted note 10 *supra*.

[35] Lynch, *Liability for Secondary Recovery Operations*, TWENTY-SECOND ANNUAL INSTITUTE ON OIL AND GAS LAW AND TAXATION 37, 38 (1971).

achieved only through the enactment and enforcement of effective legislation.

The Oklahoma statute requires prevention of waste of oil and gas resources to derive the maximum benefit therefrom. It also requires the balancing of conservation interests with the correlative rights of all property owners (including leaseholders) on any common source of supply. The same statute gives the necessary authority to the Corporation Commission to achieve and *maintain* this balance.

The Tenth Circuit Court of Appeals decision providing a "heads-I-win-tails-you-lose" remedy for the nonjoining leaseholder is certain to cause many would-be participants in unit operations to be more cautious about unitization. When unitization does take place, greater effort will be directed toward *compulsory* unitization. The net result will be to delay unitization and to afford *less* freedom to the would-be nonjoiner by compelling his participation. Hence, the court's efforts to protect the private property owner could well be self-defeating.

Where a changed circumstance occurs after issuance of a unitization order as in *Greyhound Leasing,* it is urged that the damaged party should first be required to seek rehearing before the Commission. This solution gives full scope to the Commission's fact-finding role as intended by the legislature.[36] Where the facts complicate the issues, agencies such as the Corporation Commission are better equipped to determine the facts and equitably resolve the issues than courts prone to render "all or nothing" judgments as in *Greyhound Leasing,* largely at the behest of the parties.

In view of the growing importance of secondary recovery and the similarity between Oklahoma and Colorado law, this decision would seem to call for thoughtful consideration among Colorado attorneys concerned with oil and gas law. It is urged that under the circumstances of *Greyhound Leasing,* where a significant circumstance changes after issuance of the unitization order, the alternative requiring a damaged party to seek rehearing before the Commission is by far the preferable choice.

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[36] The legislative intent was clearly expressed in the purposes of the act. OKLA. STAT. ANN. tit. 52, § 287.1 (1969). In Colorado, COLO. REV. STAT. ANN. §§ 100-6-6, -22 (1963).