Some Legal Problems Encountered in Lease Operation After Discovery of Oil

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INTRODUCTION

I am delighted to have this opportunity to present a paper to you gentlemen. I have been closely associated with the oil industry throughout my legal career and I hope the association will be permanent. One of the paramount attractions of practicing oil law lies in the character of one's clients. It is only rarely that an oil lawyer has a client who is not inherently smarter than the lawyer himself, and keeping up with his clients necessarily keeps the oil lawyer on his toes.

It would be absurd to try to discuss in one paper all of the legal problems encountered in lease operations after discovery of oil. The problems are of enormous scope and complexity and could not be adequately covered in a voluminous book. Consequently, this paper will merely attempt a general summary, without elaboration or citation of authorities, of some of the many legal problems you may encounter in your lease operations in the State of Texas.

If your having spent this time with me makes you a bit more competent to recognize the symptoms of such legal problems as they arise and refer them to your legal department or individual attorney for appropriate legal first-aid before they reach the critical stage requiring expensive and prolonged major surgery in the courts, then I will believe that I have served my purpose and that your program chairman did not make a tragic mistake by inviting me to prepare this paper.

LESSEE'S AUTHORIZED SURFACE USES UNDER TYPICAL OIL AND GAS LEASE FORMS

The basic legal instrument of the oil industry (other than the mortgage and promissory note!) is the oil and gas lease, the provisions of which largely determine the operator's rights and duties in his unending search for and production of oil and other hydrocarbons. This paper will cover only a few lease provisions which are of primary importance in your lease operations.

Although many people think all so called "Producers 88" lease forms contain identical provisions, there are probably a hundred different printed lease forms which purport to be "Producers 88 Standard Forms," and no two of these forms are identical. Lessee's rights under one lease will often differ greatly from his rights under an adjoining lease. Consequently, you must always carefully examine each lease under which you are operating to determine your legal rights under that particular lease.

However, there is sufficient similarity between the main lease clauses for us to agree that certain clauses may be considered typical -- though not standard, and certainly not identical. This paper will deal with such typical clauses.

Granting Clause

A typical printed oil and gas lease form used in Texas contains a granting clause reading substantially as follows:

> "Lessor in consideration of (X Dollars) in hand paid, of the royalties herein provided, and of the agreements of Lessee herein contained, hereby grants, leases and lets exclusively unto Lessee for the purpose of investigating, exploring, prospecting, drilling and mining for and producing oil, gas and all other minerals, laying pipelines, building roads, tanks, power stations, telephone lines and other structures thereon, to produce, save, take care of, treat, transport and own said products, and housing its employees, the following described land . . . "

If the lease is not intended to cover minerals other than oil, gas and other hydrocarbons, then the words "oil and gas" are usually substituted for the words "oil, gas and all other minerals" in the above quoted granting clause. The words "all other minerals" do not include sand and gravel, but do cover almost all other minerals which have value for mining purposes, aside from the soil itself.

Notwithstanding the oil and gas lease grants to the lessee, a certain described tract of land for the purposes stated in the granting clause, this does not mean that the lessee can use the entire surface of the leased tract for such purposes to the complete exclusion of the surface owner. The surface owner may farm or ranch the property or lease it to another for agricultural or grazing purposes, and, if the oil and gas lessee's unauthorized or negligent use injures the crops or livestock, he will be required to pay damages.

The rule is that the lessee is entitled to enter upon and use such portions of the leased tract as may be reasonably necessary for the purposes specified in the lease; and, as to such reasonably necessary portions, the lessor owns the servient estate and the lessee owns the dominant estate.

If it is reasonably necessary for the purposes specified or implied in the lease, the lessee is authorized to construct pipelines on the lease to transport oil produced thereon; build a road across the lease to haul oil, material or machinery to or from a well or well location; dig or erect storage tanks and other receptacles to measure and take care of the oil produced from the lease, or to store the salt water produced with the oil; drill disposal wells to dispose of salt water produced with the oil; erect houses for employees engaged in operating the premises; dig necessary drainage ditches and slush pits; and, although there is yet no reported case so holding, the courts will almost certainly rule that a lessee has the legal right to construct and install "Lease Automatic Custody Transfer" devices on the leased land to automatically produce and measure the oil and automatically deliver it to the pipeline.

Free Fuel and Water Clause.

A typical "free fuel and water" clause found in commercial lease forms reads:

"Lessee shall have free use of oil, gas, coal, wood and water from said land, except water from Lessor's wells, for all operations hereunder, and the royalty on oil, gas and coal shall be computed after deducting any so used."

Although this clause has apparently never been construed by a Texas appellate court, the courts in several jurisdictions have held that similar clauses do not mean a lessee can use water from the land owner's private ponds or tanks, but that he is restricted to the use of water produced by lessee by drilling wells, or building tanks or ponds, or by pumping water from running streams.

Relinquishment Act Leases on lands, in which the state reserved all minerals and made the surface owner its agent for leasing purposes, expressly provide that lessee cannot use water from the surface owner's tanks, and that the State must be paid its "royalty on production of oil and/or gas regardless of how used or disposed of."

There are thousands of sections of these lands in West Texas and, if you are operating any Relinquishment Act leases and using oil or gas produced thereon for lease operations, you are legally bound to pay the State of Texas 1/16th of the value of the oil or gas so used, as well as on the production sold to the pipeline company.

Burying Pipe Lines and Drilling Near House or Barn

Another typical lease clause reads:
"When required by Lessor, Lessee shall bury all pipe lines below ordinary plow depth, and no well shall be drilled within two hundred (200) feet of any residence or barn now on said land without Lessor's consent."

Many gathering lines in a producing field are laid on top of the surface. Unless the lessor objects, lessee has no obligation to bury such lines. The first part of this clause has been involved in very little litigation; probably because, until recently, farmers seldom plowed more than 6 to 8 inches deep. However, since the advent of deep plowing or "sub-soiling," reaching depths of 18 inches or more, we may expect more lawsuits involving the question: just how deep is "ordinary plow depth"?

I recommend that any lines which you bury in the future be buried deep enough to prevent damage by these deep plows. They are fast becoming standard equipment for many farmers, and, as deep plowing becomes more customary, the courts are likely to hold that the depth reached by these deep plows is "ordinary plow depth."

In connection with the past part of the quoted clause, you should note the word "now" as used therein. The prohibition against drilling within 200 feet of a house or barn means one on the land at the date of the lease and not one constructed thereafter. Except for this provision, the selection of the place to drill, as well as the time, is an absolute right of lessee even though the time and place selected result in unusual expense and inconvenience to lessor.

If a well is drilled within 200 feet of a house or barn with lessor's consent, you should secure such consent in writing. If you do not, and at some future date your activities on this well cause a blowout, explosion or fire which injures lessor's house, barn or the contents thereof, or the lessor or his family, you may be unable to prove lessor's consent to your drilling at this location and be held liable to damages, even though the injuries were not caused by your negligence.

Damages to Growing Crops

Although most older lease forms contain none and it cannot yet be called a typical clause, many new lease forms provide that:

"Lessee shall pay for damages caused by its operations to growing crops on said land."

In the absence of such a clause in the lease, or in a tenant's consent agreemet from a surface tenant, lessee has no legal obligation to pay for damages to such crops resulting from his non-negligent use of only so much of the surface as is reasonably necessary for the purposes specified or implied in the granting clause of the lease. However, it has become a custom of the industry to pay such damages as a matter of public relations, even though there is no legal obligation to do so. It has been held that the word "crops" means cultivated plants such as wheat, cotton, milo, etc., and does not include the natural products of the soil, such as native grasses used for grazing cattle.

Removing Equipment from Lease

Another typical provision contained in many commercial lease forms reads:

"Lessee shall have the right at any time during or after the expiration of this lease to remove all property and fixtures placed by Lessee on said land, including the right to draw and remove all casing."

However, the law of Texas is that, even though the lease uses the words "at any time," lessee only has a reasonable time after termination of the lease to remove such equipment. The question of what is a "reasonable time" depends upon the surrounding circumstances of each case. Two years was held reasonable where lessor and lessee were negotiating the matter of deepening the well in order to continue production, and sixteen months was held a reasonable time where lessee was involved in receivership and bankruptcy proceedings.

However, where there are no circumstances tending to justify lesses's delay in removing equipment from the lease, the courts are likely to hold that a reasonable time is much shorter, possibly six months or less, and refuse to allow the procrastinating lessee to pull and remove his casing and other equipment on the basis that he has forfeited title to same and it is now owned by the landowner.

Restoration of Surface

As we have seen, the oil and gas lessee is not liable for reasonable surface damage resulting from authorized and non-negligent lease operations. It follows that lessee owes no legal duty to the surface owner to restore the surface of the lease to the condition it was in, prior to the drilling of the well, by filling in and leveling slush pits and cleaning up the well location after drilling operations have terminated, unless the obligation to do so is expressly included in the lease.

This is true even though it is customary in the oil industry to clean up and level well locations when a lease is abandoned. The first Texas case announcing the rule that lessees need not restore the premises is of recent date and we can expect that in the future many more lessors will insist upon an express clause in the lease requiring lessees to restore the surface.

Exclusive and Non-exclusive Authorized Uses

Although the right to use the surface to drill for and produce oil from the leased premises is certainly an ex-

clusive right of a lessee whose lease covers the entire mineral estate at all depths, some of the lessee's rights under an oil and gas lease may not be exclusive, unless the lease expressly makes them so. The words "investigating, exploring, prospecting" in the granting clause authorize lessee to conduct geophysical operations, which include surface operations and the drilling of seismograph holes on the leased premises.

The above quoted granting clause gives lessee the exclusive right to conduct such geophysical operations and the land owner cannot authorize third parties to conduct such operations on the lands covered by the lease. If third parties attempt to conduct such geophysical operations without lessee's permission, it seems they can be enjoined from so doing, and a lessee may be able to recover for any damages caused to him by such operations. The measure of damages should probably be the market value of the right to explore by geophysical means.

However, where the lease in question does not expressly make the right to explore and prospect exclusive, it has been held that lessee's right to explore by geophysical means on the leased land is not exclusive, so that the landowners can authorize a third party to conduct geophysical operations on the lease without securing permission from the oil and gas lessee.

Also, a lessor seems to have the legal right to construct, or to grant to third parties the right to construct, pickup stations to gather waste oil flowing over the lease from outside sources, so long as such pickup stations do not unreasonably interfere with lessee's operations or lessee's right to save the waste oil produced from his own lease.

However, it is important to note that the leases involved in the cases announcing this rule did not grant to lessee the exclusive right to build such pickup stations. Had the leases so provided, the court would have surely held that only the lessee could build such pickup stations on the leased premises.

The law is well settled that a surface owner has the right to grant to other persons easements for pipelines, electrical transmission and telephone lines etc. across the land covered by an oil and gas lease, provided such easements do not unreasonably interfere with the rights of the oil and gas lessee; and the lessee owes the owners of such easements a duty of using ordinary care to avoid injuring same.

Where the oil and gas lease covers land which was previously subdivided into town lots and the streets and alleys dedicated to the public, lessee has no right to locate wells, dig pits or locate lease equipment on such streets and alleys, even though they have never been graded or used by the public. Consequently, the town or city, or any individual town lot owner who is specially harmed by the obstructing of the street or alley by the lease equipment, has a right to demand that the lessee remove the obstruction, and the lessee cannot acquire a legal right to maintain the equipment at its obstructing location through adverse possession.

ENFORCEMENT OF SURFACE RIGHTS

The proper way for the oil and gas lessee to enforce his rights to use the surface, when it is disputed by the surface owner or surface lessee, is by injunction. It is not an uncommon situation for a disgruntled surface owner or surface lessee of lands leased for oil and gas to contest the right of the lessee to come on the land and use the surface for the authorized purposes stated in the oil and gas lease. This is most likely to occur when the surface and mineral estates have been completely severed by a grant or reservation of all the minerals in a deed prior to the lease.

Since a surface owner in this position receives none of the bonus, delay rentals or royalties payable under the lease, both he and his surface lessee are understandably somewhat perturbed by the oil operator's activities which substantially impair the value of the surface estate and often injure his livestock. Consequently, lessee's employees are sometimes met at the lease entrance by an irate farmer or rancher who refuses to allow them to come on the lease, at least until he has been paid in advance for his real or imaginary damages.

Sometimes too, the person blocking the way is supported by a very persuasive authority in the form of a rifle or shotgun. This is an excellent time for the operator or his employees to remember that "discretion is the better part of valor" and, although they may have a perfectly legal right to proceed onto the lease, the wiser course is to have their attorney secure a court injunction enforcing their right to do so.

The injunction is nothing more than a court decree ordering the person contesting lessee's right of entry to cease and desist immediately; and, if the injunction is not obeyed, the recalcitrant party may be jailed for contempt of court. For psychological reasons, it is usually advisable to secure the injunction from the Federal District Court when the jurisdictional requirements can be met. The serving of a federal court injunction by the United States Marshall has a more pronounced sobering effect on the irate landowner than the service of a similar state court order by the local deputy sheriff.

Most of these situations cause lessee's drilling rig, or other expensive equipment and the crews operating them, to be idle for a few days, and may result in termination of the lease where immediate drilling is necessary. The lessee is entitled to recover from the guilty party the damages caused to lessee by this unlawful delay.

UNAUTHORIZED SURFACE USES

A landowner or his surface lessee is entitled to legal redress against a lessee who uses the land for an unauthorized purpose, or who uses more of the land than is reasonably necessary, even though used for an authorized purpose and even though no negligence is involved.

An oil and gas lessee cannot use all of the surface of the lease for constructing salt water disposal pits; nor can he grant to the lessee of an adjoining tract the right to drill a directional well, located on his lease but bottomed under such adjoining tract.

Likewise, a lessee who owns two or more leases adjoining each other or in the same area cannot build pipelines and storage tanks on one lease to transport, store and treat oil produced from a different lease, or construct a gasoline plant on one lease to process gas produced from all of the leases, unless the leases expressly grant such rights. Neither is the lessee authorized to drill a water well on one lease and use the water produced therefrom in his operations on another lease, nor can he ordinarily use a road built on one lease to go to and from another lease.

Because the use of the leased premises in connection with other adjoining leases can result in more efficient operations and substantial economies to the lessee, the granting clauses in some recent lease forms have been expanded to include the words "alone or conjointly with any adjacent land," or the words "regardless of whether such structures and facilities are used exclusively for the products from the hereinafter described premises."

LESSEE'S LIABILITY FOR INJURIES CAUSED BY LEASE OPERATIONS

All, or nearly all, of lessee's authorized activities, which have been mentioned above, result in actual damage

to the surface owner or surface lessee, but the lessee generally has no liability for such damages because the oil and gas lease permits him to do such damage as is reasonably necessary in carefully carrying out these activities. However, if the lessee or his employees are negligent in carrying out these authorized activities, lessee will probably have to pay for the damage resulting from such negligence.

Generally speaking, a lessee or his employees are guilty of negligence when they do something which a reasonably prudent man would not do, or fail to do something which a reasonably prudent man would do, under the same or similar circumstances.

There is no liability for damage resulting from negligence unless the negligent party owed to the injured party a duty to act with some degree of care. When the prospect develops of a legal claim or litigation based on lessee's alleged negligence, it should first be determined whether the damage or injury was sustained by or upon the leased premises, or by or upon adjacent land.

The duties imposed by law upon a lessee to prevent damage to another, depent largely upon the relationship between lessee and the injured party. The rules pertaining to lessee's liability to a person off the leased premises are often more onerous than the rules pertaining to his liability to his lessor and others on the leased premises.

Injury to Property of Others on the Lease

Livestock on the lease are often injured or killed by drinking from waste disposal pits or by coming in contact with dangerous machinery. The operator owes lessor no duty to fence off his pumping wells and necessary pits, ponds, tank batteries and the like unless the lease contains a provision requiring it. Therefore, since there is no duty, failure to fence such equipment in a manner to prevent injuries to livestock is not actionable negligence and lessee is not liable for the injury to, or death of, livestock drinking from the pits, sticking their heads in pump jacks, etc.

If lessor wants to make sure his livestock are not injured in this manner, lessor must himself erect fences denying his livestock access to such lease equipment. The courts often say in these cases that the livestock are trespassers and the only duty owed by lessee to lessor is to not intentionally, willfully or wantonly injure his livestock.

I must here again caution you to check the provisions of the particular lease form under which you are operating. Many lessors now insert a clause whereby lessee expressly agrees to fence off all pits, pumps and other equipment so that livestock on the lease cannot come in contact with them; a few recent printed lease forms contain such a clause. When such a clause exists, but lessee fails to comply and lessor's livestock are injured or killed, lessee is liable under the contract, regardless of any negligence.

Where lessee negligently permits waste oil, salt water, chemicals, etc., to escape and flow onto portions of the lease which are not reasonably necessary in carrying out the objects of the lease, the use if not authorized and lessee will probably be held liable for injury to livestock resulting therefrom. In this situation, the cattle cannot be reasonably considered as trespassing on that part of the lease covered by the escaped substance, and lessee does owe a duty to use care in preventing injury to them. His failure to use care is actionable negligence.

Lands covered by oil and gas leases are often crossed by buried pipelines, telephone conduits, etc., owned by other companies and which may be difficult to discover by mere observation of the surface. Such underground lines are quite regularly severed or damaged by the oil and gas lessee's operations on the lease.

In one case pointing up this potential liability, a pipeline company sued the lessee to recover damages for the breaking of its pipeline and consequent loss of product, allegedly caused by the negligence of lessee's employees. Lessee's employees had loaded part of a drilling rig on a truck and were attempting to move it after heavy rains, with the assistance of tractors and winch lines. In dragging the loaded truck to a new location on the lease, they crossed over and broke the pipeline which had been laid across the lease under an easement granted by the landowner.

Lessee contended that it had no actual knowledge of the pipeline and the danger of injury to it, and therefore had no duty to exercise care in moving its rig across same. In rejecting this contention and holding lessee liable for the cost of repairs to the line and loss of product, the court ruled that if the lessee had, through its superintendent in charge of operations or otherwise, actual or constructive notice of the existence and location of the line, then lessee must exercise ordinary care to avoid injuring the same.

Injury to Property of Others on Adjoining Lands

Permitting salt water, oil, chemicals and other deleterious substances to escape and flow onto adjoining lands, either on the surface or in underground strata, quite often results in operators being held liable for the resulting injuries to, or destruction of, property or animals. In nearly all Texas cases, the Courts have denied liability unless the claimant could prove 1. specific acts of negligence on the part of the operator or his employees, 2. that the injury was caused by such negligence and 3. that the injury was of a type reasonably foreseeable.

However, in a recent Texas Civil Appeals case where operator was carefully disposing of salt water by use of disposal pits in the customary and usual manner, and there was no evidence of negligence in the usual sense which could render the operator liable for the pollution of an underground fresh water strata under adjoining land, the operator was nevertheless held liable and required to pay damages of $22,000.

The court said, in effect, since Railroad Commission Rule 20 specifically prohibits pollution of fresh water by disposal of salt water without any reference to negligence, an oil operator who has admittedly polluted an underground fresh water strata is liable under the rule, regardless of the absence of any negligence. The Texas Supreme Court refused to take jurisduction of this case and, as a result, the Texas law is now in a state of considerable confusion as to whether proof of negligence is a prerequisite to lessee's liability in these cases.

This case has been severely criticized by many legal authorities, and I think rightly so. The Texas Supreme Court long ago rejected the English doctrine of "liability without fault" in cases where deleterious substances escape from one person's property onto another's, but this case comes very close to applying that doctrine and seems to conflict with prior Supreme Court cases. The courts of at least six of the other major oil producing states find liability in these cases without proof of negligence in the usual sense, and Texas may now be the seventh. In any event, lessees should use extreme care in disposing of salt water.

Operator's Liability

Where several lease operators allow salt water, oil or

other deleterious substances to escape and damage adjoining land or pollute freshwater strata under adjoining land, and the substances escaping from the several leases contribute to the indivisible injury in various proportions, the majority rule (and the Texas rule prior to 1952) requires the injured party to prove with reasonable certainty the portion of the injury each operator caused before he can recover damages.

In most instances, especially in pollution cases, claimants cannot prove this and are denied all recovery. In 1952 our Supreme Court held there was joint and several liability in such situations and the claimant could recover for all his damages from any one of the operators involved, reasoning that justice is better served by requiring one of the wrongdoers to pay the entire amount than by refusing any recovery to the innocent claimant.

This doctrine of "joint and several liability" applies even though some of the operators involved were not guilty of any negligence; but the operator who is required to pay the entire claim may sue the other operators and recover, from those who were negligent, their rightful share of the total amount the court required him to pay the innocent claimant.

One very interesting and much written about case involves an operator's liability to adjoining landowners for waste. Operator attempted to drill a well on his lease offsetting a producing well on another lease. During the process of drilling, the well blew out, caught fire, subsequently cratered and, after great quantities of gas and distillate had escaped, the well on the adjoining land ceased to produce.

The adjoining landowners sued operator for the value of the escaped gas and distillate which was originally under their land, alleging the blowout resulted from operator's negligence. The Court found operator was negligent and awarded the claimants a tidy sum. This case establishes the general rule that an operator who is guilty of negligence, resulting in waste, is liable for damages to the other owners in the pool.

SECONDARY RECOVERY AND FIELD-WIDE UNIT OPERATIONS

Although some of us think of secondary recovery as relatively new in the oil business, repressuring was in common use in the Appalachian fields as early as 1916. There is still, however, very little Texas law on the subject. As oil resources are depleted, and consequently become more valuable, secondary recovery operations will become progressively more important and widely used. They may quite possibly become mandatory, because the great majority of the oil in reservoirs where a natural water drive is not present cannot be recovered without resort to such operations. Plugging wells when only 25 per cent of the oil in place has been produced is economic waste which this country can ill afford.

Secondary recovery operations are ordinarily carried out by water flooding or repressuring, using certain wells in the field as water, gas, or air injection or input wells to replenish reservoir energy and force the oil to migrate to other producing wells. This is generally feasible only when all leases in an entire pool are operated as a unit.

Consequently, in Texas and other states having no statutes requiring forced unitization, a voluntary field-wide unitization agreement is a prerequisite to efficient secondary recovery operations, except in the very few instances where an entire pool is circumscribed by one lease covering a large body of land. Even where one lease does cover the whole pool, it seldom contains express provisions authorizing the lessee to conduct secondary recovery operations by gas, air or water injection, and lessee's right to do so has been contested in some cases in other states.

Fortunately, most of these cases seem to announce a general rule to the effect that when the lease is silent as to the methods of production, it must be presumed to permit any method reasonably designed to accomplish the purpose of the lease, such purpose being the recovery of the oil and the payment of royalty to the lessor.

It is obvious that the courts cannot supply the remedy for most secondary recovery problems by interpreting conventional printed lease forms because, as stated above, rarely is a leased tract co-extensive with the boundaries of a producing formation so that efficient secondary recovery operations may be conducted within the geographic limitations of a single lease.

The terms of the lease contract must be enforced by the courts, and a lessee will not ordinarily be authorized to dedicate his lease to a secondary recovery unit without first obtaining the written consent of his lessor and the owners of nonparticipating royalty, overriding royalty and production payment interests burdening his lease. Without their consent, he cannot extend the term of his lease by production from some other part of the unit; he cannot absolve himself from the expressed and implied obligations of his lease; he cannot transfer allowables; and he cannot arbitrarily change existing royalty, overriding royalty and production payment interests from an agreed fraction of the production from the leased premises to field-wide unit. A voluntary field-wide unitiazation plan involves an Operators Agreement, a Royalty Owners Agreement and, usually, a Plant Agreement and various easement agreements with the owners of completely severed surface interests within the unit area. The negotiation and preparation and securing the execution of these legal instruments by great numbers of parties is a tremendously complex, expensive and time-consuming task for the engineers, lawyers and landmen.

This is probably the principal reason why a very small percentage of the oil fields in Texas are now operated under unit agreements. This is, perhaps, an appropriate place to point out that all unit agreements should contain provisions for dissolving and terminating the unit when it has served its purpose. If it does not, then all of the numerous participants or their heirs and assigns may have to be again contacted years later and persuaded to execute an instrument terminating the unit in order to clear the titles to the mineral and royalty interests formerly in the unit.

The Texas courts have held that a unitization agreement constitutes a cross-conveyance among the owners in the unit of their interests in the minerals involved. Each owner who signs, grants an interest in his tract to every other signer and acquires an interest in every other tract. Thus the unit agreement is more than an agreement; it is also a conveyance, and it must be in writing and properly executed by the interest owners.

Where a unit has been once formed, and a lessee of one tract later files suit to have his lease removed from the unit, all interest owners in the unit are necesarry parties to the suit. All must be joined in the lawsuit as either plaintiffs or defendants, and all defendants must be served with citation before the court can grant any relief. This makes many lessees and landowners very reluctant to commit their interests to a unit comprising hundreds or even thousands of participants, some of whom may live in every state in the union and many foreign countries.

Even after the unit becomes effective, there is still a great deal of work to be done by both lawyers and engineers. The Railroad Commission, which must approve the unit agreement and the programs therein provided for, has continuing jurisdiction over the unit and its pressure regulation operations. The unit must continue to secure its

permission for transfers and increases of allowables, drilling or conversion of producing and input wells, amendments to field rules, and other matters.

The services of lawyers are also needed for the interpretation of the agreements and to cope with the legal problems which always arise in the operation of an important endeavor which daily comes in contact with regulatory and governmental authorities and the general public; and which raises numerous legal problems between the participants themselves.

The pre-existing oil and gas leases, including their expressed and implied covenants, remain in full force and effect after inclusion in the unit, except as modified by the terms and provisions of unit agreement.

Some of the legal consequences as between the lessors on the one hand and the lessees on the other, of a unitization agreement which has been executed by all interest owners, in the absence of express contrary provisions in the agreement, are as follows: all included leases are perpetuated beyond their primary terms for as long as production continues from any lease in the unit; the commencement of a well on any lease in the unit excuses payments of delay rentals on all leases; all leases are relieved of the implied covenant to reasonably develop each lease separately; both production and injection wells may be located without reference to property lines or lease lines; and all leases are relieved of the obligation to drill off-set wells within the unit.

As between the lessors themselves, each gives up his legal rights to have his own tract separately developed, to receive all royalties on all production from his tract, and to have off-set wells drilled to prevent drainage from his tract by wells on other tracts in the unit; and each lessor gains the right to share proportionately in the royalties on production from the entire unit. In short, the parties to a unitization agreement agree that commercial production from any tract in the unit will be regarded during the life of the unit as production from every tract included therein.

When, as often happens, only parts of some leases are included within the unit, the un-unitized portions of the leases are probably held by production within the unit; but as to the portions not included, the lessee is still subject to the obligations to reasonably develop and prevent drainage. If he fails to live up to such obligations, the court may require him to pay damages to the lessor; and, in addition, he may be required to release the un-unitized portion of the lease unless he drills the reasonably required wells within a short time.

All field-wide unitization agreements provide for allocating the total unit production to the separate tracts in the unit on the basis of an agreed percentage participation by each tract. The production allocated to each tract is delivered in kind to the lessee of each tract, who separately disposes of same and accounts for all royalties, overriding royalties and other payments out of production burdening his particular lease.

Un-unitized Interests

My remarks thus far in connection with secondary recovery and unit operations have assumed that all interest owners in the unit area executed the unit agreement. Unfortunately, this is seldom the case. There are almost always a few royalty, mineral or working interest owners who flatly refuse to join in the unit, or who cannot be found, or whose signatures cannot be secured for some other reason. Consequently, most units contain a few "windows" or tracts in which a part, or all, of the interest owners have not joined in the unit. A great many, and possibly a majority, of the problems arising after a unit is put in operation are direct results of these un-unitized interests within the unit area.

In Texas, the interests cannot be force pooled, and the pre-existing leases covering un-unitized mineral and mineral interests remain in force as originally written. Utmost efficiency in unit operations requires that engineers be completely unrestricted by lease and property lines in the location of injection and production wells, the manner of their operation and the transfer of allowables. The existence of these "windows" result in several legal restrictions on the engineers. Consequently the more "windows" existing in the unit, the less efficient the unit operations.

The placing of an input well on an unsigned tract will drive oil from that tract to adjoining tracts. Converting a producing well to an input well will do likewise and, in addition, reduce the production from the "window" by the amount the well had been producing. The doing of either will result in liability for uncompensated drainage.

Where the unsigned interest is a mineral interest covered by a lease, and the lessee has joined in the unit, the drilling of only input wells or the failure to drill on the partly unitized tract will result in termination of the lease, at least at the end of its primary term, so that a partly unitized tract becomes a wholly un-unitized tract. In this situation, the lessee of the tract is bound, prior to the expiration of his lease, both by the terms of his lease and the terms of the unit agreement.

When a unit area contains un-unitized royalty interests, the entire production from the unit cannot be commingled in central storage tanks. Production from wells on each "window" must be run into separate tanks, and measured and accounted for separately from all other production from the unit, with considerable additional expense of time and money for bookkeeping, extra tank batteries, and for the actual measuring and running of the oil.

The actual production and the allocated production from a tract in a unit is never the same. Lessee gets only the production allocated to the tract, but he must pay royalty to the non-signing royalty owner on the basis of actual production.

The non-signing royalty owner situation may also result in liability for uncompensated drainage caused by the transfer of allowables 1. from high gas-oil ratio to low ratio wells, 2. from wells making excessive salt water to wells making less or none, and 3. from wells converted to input wells. Permission to transfer allowables in these instances is usually contained in the field rules, and such transfers are essential if the unit is to operate at peak efficiency.

However, if the Railroad Commission field rules applicable to the unit contain provisions designed to reasonably protect the legal rights of the non-signing interest owners, if the Commission finds that such provisions will afford such protection, and if the unit operator carefully complies with the rules, then the Commission's order will probably be the basis of a good defense to a suit for damages by the non-signing interest owner, even though he can prove some uncompensated drainage from his tract.

As pointed out above, under "UNAUTHORIZED SURFACE USES," the surface of, and water under, a tract covered by a conventional lease may be used only for the benefit of that lease and not for any other lease. The examples there given also apply in the situation where the working interest has been committed to a unit but the royalty interest has not.

Furthermore, even when a unit area is completely unitized as to all owners of any interest in the minerals, surface use problems are created by the fact that the

mineral and surface estates in some tracts have usually been completely severed and the surface owners have no interest whatsoever in the oil underlying such tracts.

Since they will receive no royalty from production, they have no incentive to cooperate with the unit operator; but maximum unit efficienty will probably require that portions of their surface be used for input wells, pipelines, tank batteries, pump stations or other equipment essential to unit operations. Consequently, the unit operator must negotiate and purchase easements from such surface owners, or be held responsible for unauthorized surface uses.

LEASE AUTOMATIC CUSTODY TRANSFER (LACT)

LACT is apparently such a new innovation that no legal problems concerning it have yet been presented to the appellate courts for determination. As much as my very limited knowledge of this innovation qualifies me to predict, it is my opinion that about the only new legal problem presented by it is that special permission must be secured from the Railroad Commission for each installation.

Insofar as false measurements, escape oil, injuries to crops, livestock and other personal property, and pollution of fresh water strata may result from faulty equipment, or negligent installation or operation of LACT devices, I feel that liability will be determined by the same legal rules the courts have heretofore applied to determine liability for such damages when they resulted from the use of older methods and equipment.

Unless you engineers have perfected automation devices to the point where they are more intelligent and less subject to error than we humans, there is, of course, the possibility that mechanical failures will result in the escape of larger quantities of oil, as there will be no one on the lease to detect the trouble and promptly correct it.

MECHANIC'S AND MATERIALMEN'S LIENS

Service companies, supply companies, drilling contractors and others who furnish material, service or labor in the development of oil properties may acquire a lien thereon, under existing statutory provisions.

The statutes give to original contractors who perform labor or furnish material, machinery or supplies in connection with the development, production and distribution of oil, a lien on the leasehold estate, and a very similar lien is given to subcontractors. Thus, when a drilling contractor drills a well but engages a subcontractor to complete it, the lessee fails to pay the contract and the contractor fails to pay the subcontractor, both the contractor and the subcontractor are entitled to liens on the leasehold estate, including the material and equipment thereon owned by lessee; provided, they comply with the procedural requirements of the applicable statutes.

Furthermore, if the drilling contractor receives prompt payment but fails to pay the subcontract, the subcontractor may still be entitled to a lien on the leasehold. In order to protect themselves against this possibility, it is advisable for lessees to deal only with financially responsible drilling contractors and to insert in their drilling contracts a provision for indemnity against liens, claims or demans made by subcontractors, supply houses, etc., so the contractor will be obligated to defend any suit.

The procedural requirements which must be followed in order to fix an enforceable statutory lien on the leasehold are, generally, that the lien claimant must 1. give notice of the lien in writing to the persons and within the time prescribed by the applicable statute, and 2. file his contract, or if he has no contract, his sworn itemized account of the claim, in the office of the County Clerk of the county where the property is situated and within the time allowable by the statute (which is six months for original contractors and three months for subcontractors,

When the contract or sworn account is filed within the time allowed, the lien thereby fixed on the property relates back to, and becomes effective from the time when the work was performed or the material furnished, and is given priority over a written mortgage placed on the property after the work was performed or material furnished, even though the mortgage was filed before the contract or sworn account.

The underlying reason for the granting of such involuntary liens is that one who increases the value of an oil lease owned by another by expenditure of labor or material theron, under a contract express or implied, ought to the extent of the contract price or value of the thing furnished, to have a lien on the leasehold to secure payment.

A compelling reason for operators to keep their own bills paid, and make sure their contractors pay their bills, is that the pipeline company usually stops payments to the lessee when it receives notice of a lien being filed. In fact, many pipeline companies require proof that there are no unpaid bills affecting the working interest before they ever start paying for the oil run from the lease.

There is one Texas Civil Appeals case decided in 1924 which seems to hold that such liens do not attach to oil runs from the lease subject to the lien or to the proceeds from such runs. In my opinion, the reasoning in this old case is unsound, and there is no other case following it. The Texas Supreme Court has never decided this question, and there is still doubt as to what the Texas law really is on this point.

CONCLUSION

As was said in the introduction, the foregoing is at best only a brief summary of the legal problems and the general rules formulated by the courts to solve them. Unusual fact situations often cause courts to make exceptions to general rules. Therefore, when you consult your attorney about a legal problem you have encountered in the field, you should always advise him of all the facts known to you which could reasonably have any bearing on the problem. He will then be better able to decide whether the general rule or one of its exceptions will be applicable.