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THE LAW OF OIL AND GAS IN WYOMING: AN OVERVIEW

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In an article written more than thirty years ago, Professor Kuntz commented upon the future development of oil and gas law in Wyoming:

> It should be possible to do what the Wyoming Supreme Court has already exhibited a tendency to do, and that is to adopt no ready-made, comprehensive accumulation of decisions from another state, but to accept only those parts which will round out a body of law containing certain basic concepts for purposes of stability, yet having sufficient flexibility to meet the demands of practical consideration as technology and business methods in the field progress, and from which problems as yet unforeseen may be treated with a minimum of difficulty and contradiction.[1]

To a large extent, that statement stands today as an accurate characterization of the development of oil and gas law in the state. As the following pages reveal, the involvement

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1. Kuntz, *Law Relating to Oil and Gas in Wyoming*, 3 WYO. L.J. 107, 107 (1949).

of both the courts and the legislature of Wyoming in shaping the law has been minimal, dealing with specific problems as they arise and tailoring the solutions to fit practical needs. A few minor inconsistencies have been noted, but none of real consequence.

The writer's objective in this article is exactly what the title implies: to provide an overview of the law of oil and gas in Wyoming. It does not purport to be an exhaustive treatment of all the facets of the law in the state. It is rather an effort to identify the principles adopted by lawmakers to deal with a variety of problems in the context of oil and gas. For ease of organization, the article is divided into three sections. The first concentrates on the nature of interests in oil and gas, including ownership theory and the consequences of the classification of interests in those resources. The second section deals with the legal protection extended to an owner of interests in oil and gas. The final section relates the fairly recent development of efforts to conserve the resources of Wyoming through well spacing, pooling and unitization.

I. THE NATURE OF INTERESTS IN OIL AND GAS

The Supreme Court of Wyoming has experienced some difficulty in answering several fundamental questions regarding the character of interests in oil and gas: What is the nature of the landowner's interest in the minerals in and under his land? How can interests in oil and gas be characterized, within the context of real property law? What are the consequences of those characterizations? The court's efforts to deal with those issues have resulted in decisions which are sometimes vague as to the theory applied.

That observation should not be interpreted as critical of the Wyoming court. If there is anything common to the law of the various oil- and gas-producing states, it is the general confusion as to the nature of interests in those resources. Also, since so few cases have turned upon the question of which theory applies in Wyoming, the practical effects of the court's vagueness have not been significant.

A. *The Nature of Ownership in Oil and Gas*

Several theories have developed as to the nature of ownership in oil and gas, among them nonownership theory, qualified ownership theory, ownership in place theory, and ownership of strata theory. Simply stated nonownership theory holds that no person owns oil and gas until it is produced.[2] That doctrine is essentially an extension of the "rule of capture" and stems from the view that oil and gas is migratory in nature. Under qualified ownership theory, owners of land lying over a common reservoir each have certain correlative rights (and duties) in connection with the oil and gas below.[3] The rule most often applied to interests in oil and gas is ownership in place theory, which holds that the nature of the landowner's interest in those substances is the same as his interest in solid minerals contained in his land.[4] Finally, decisions from a few jurisdictions have held that the landowner owns the sedimentary layer containing the oil and gas within the limits of the vertical planes which bound his land, the so-called ownership of strata theory.[5]

It is difficult to determine which of those theories applies in Wyoming. In the early case of *State v. Snyder*, the Supreme Court of Wyoming quoted approvingly from an Illinois decision holding that "(o)wing to its fugitive nature, a grant of the oil under the ground is a grant, not of the oil in place in the earth, but of such oil as the grantee may find there and save;" obviously, language of nonownership theory.[6] In *State ex rel. Cross v. Board of Land Com'rs.*, the same court quoted from Thompson on Real Property that "[s]ince minerals in place are part of the land, the owner of the fee in the land has the absolute right of property in the mines and quarries beneath the surface . . . ."[7] Similar language of ownership in place theory

2. 1 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 203.1 (1981).
3. *Id.* § 203.2.
4. *Id.* § 203.3.
5. *Id.* § 203.4.
6. 29 Wyo. 163, 191, 212 P. 758, 763-64 (1923) (quoting Ohio Oil Co. v. Daughetee, 240 Ill. 361, 88 N.E. 818, 826 (1909)).
7. 50 Wyo. 181, 202, 58 P.2d 423, 430 (1936) (quoting 1 THOMPSON ON REAL PROPERTY § 87).

can be found in the later cases of *Denver Joint Stock Land Bank v. Dixon*, where the court stated that the direct interest in the *oil in place* had been reserved,[8] and *Picard v. Richards*, where it was held that a conveyance or reservation of a mineral interest gave title to the *oil in place*.[9] In the last-named case, the court cited cases from ownership in place, nonownership and qualified ownership theory states.

At least one writer has concluded that Wyoming adheres to ownership in place theory.[10] Professors Williams and Meyers disagree, pointing out that "the classification of leasehold interests as profits *a pendre* (see discussion below) is some evidence that the ownership in place theory is not adopted." The professors categorize Wyoming as a nonownership theory state.[11]

Ultimately, the determination of whether nonownership theory or ownership in place theory applies to interests in oil and gas in Wyoming is of small consequence. In their treatise, Professors Williams and Meyers end their discussion of the legal consequences of the various theories as to the nature of the landowner's interest with the following remarks:

> [T]he theory held by the state is of little importance apart from its influence on the classification of mineral, royalty and leasehold interests as corporeal or incorporeal . . . The fact that little if any discussion is found in cases from states recently arriving on the oil and gas scene is evidence of the insignificance of the theory to the adjudication of controversies. Further evidence is found in the infrequency of discussion of the matter in opinions in any state and the difficulty observed in ascertaining the theory held in certain states by reason of inconsistencies in the opinions from such states.[12]

B. *Classification of Interests in Oil and Gas*

It has long been recognized in most jurisdictions that the landowner may create three types of interests in oil

8. 57 Wyo. 523, 122 P.2d 842 (1942).
9. 366 P.2d 119 (Wyo. 1961).
10. Note, *Classifications, in Wyoming, of Interest in Oil and Gas for Various Purposes and Their Consequences*, 17 WYO. L.J. 80, 82 (1962).
11. 1 H. WILLIAMS & C. MEYERS, *supra* note 2, § 203.1.
12. *Id.* § 204.9.

and gas—leasehold interests, mineral interests, and royalty interests.[13] In the case of *Boatman v. Andre*,[14] the Supreme Court of Wyoming recognized the oil and gas lease as a right granted by the holder of the mineral estate giving one lessee the authority to search for oil and gas and to remove either if found. Prior to 1961, none of the decisions of the court distinguished between a mineral interest[15] and a royalty interest.[16] The terms were used interchangeably, leading one writer to characterize the two terms as synonymous.[17] Finally, in *Picard v. Richards*,[18] the court recognized that "There may be an estate interest in minerals, larger than a royalty interest, which . . . is called a 'mineral estate', at times stated as a 'mineral interest'. It is an estate in fee simple in and to the minerals."[19]

1. The Corporeal-Incorporeal Distinction

The leading case in Wyoming concerning the corporeal-incorporeal distinction is *Boatmen v. Andre*.[20] In that case, the supreme court faced the question of whether the estate granted by an oil and gas lease could be lost by abandonment.[21] The court observed that while title to land cannot be lost by abandonment, the right created by an oil and gas lease is in the nature of a profit *a prendre* and therefore an incorporeal hereditament, which may be abandoned. The

13. *Id.* § 202.
14. 44 Wyo. 352, 12 P.2d 370 (1932).
15. "The owner of the full mineral interest in particular premises normally has the right to go upon the premises for the purpose of prospecting for, severing and removing therefrom all minerals . . . A severed mineral interest normally includes development and executive rights, *i.e.*, the right to drill or to execute an oil and gas lease." 1 H. WILLIAMS & C. MEYERS, *supra* note 2, § 202.2.
16. "[A royalty interest] differs from a mineral interest in that the owner is not authorized to go upon the premises in which the royalty interest exists for the purpose of prospecting for, severing and removing minerals. . . . The owner is, however, entitled to share in such minerals as are severed, or the proceeds thereof." *Id.* § 202.3.
17. Note, *Oil and Gas Royalty Synonymous with Mineral Interest*, 1 WYO. L.J. 92 (1947).
18. 366 P.2d 119 (Wyo. 1961).
19. *Id.* at 123.
20. *Supra* note 14.
21. The question of abandonment of an oil and gas lease had reached the Supreme Court of Wyoming once before in the case of Phillips et. al. v. Hamilton, 17 Wyo. 41, 95 P. 846 (1908). In that case, the court did not decree a forfeiture of the lease, nor did it discuss the corporeal-incorporeal distinction.

court concluded that the leases involved in that case had been abandoned.

Professors Williams and Meyers list a number of possible consequences of the classification of an interest in oil and gas as incorporeal, including the possibility of abandonment.[22] The professors go on to conclude that in terms of practical effect, the corporeal-incorporeal distinction has "little importance."[23] That conclusion is supported by the fact that since *Boatman v. Andre*, no reported Wyoming cases have held an interest in oil and gas to have been extinguished by abandonment.

2. The Realty-Personalty Distinction

Before tracing the development of Wyoming oil and gas law with respect to the realty-personalty distinction, it should be noted that the classification of an interest in oil and gas as realty or as personalty is unrelated to the corporeal-incorporeal distinction. The two questions are "separate and distinct" from one another: "(t)he former classification is made on the basis of duration, the latter on its possessory nature."[24]

The question of whether an interest in oil and gas is realty or personalty was broached in the case of *State v. Snyder*.[25] That case involved a constitutional provision that all proceeds from the sale or lease of school lands belong to the corpus of the school fund.[26] The Supreme Court of Wyoming held that proceeds from a royalty interest in school lands should be included in the permanent school fund, as oil and gas, while in situ, are a part of the realty.

The question arose in a different context in *Denver Joint Stock Land Bank v. Dixon*.[27] The plaintiff in that action had foreclosed under a mortgage containing general words of conveyance without reservation. The defendant,

22. 1 H. WILLIAMS & C. MEYERS, *supra* note 2, § 210.
23. *Id.* § 211.
24. *Id.* § 212.
25. 29 Wyo. 163, 212 P. 758 (1923).
26. WYO. CONST. art. 7, § 2.
27. *Supra* note 8.

a grantee of a royalty interest under an assignment made subsequent to the mortgage, contended that an interest in oil and gas is personalty and does not pass under general words of conveyance. The supreme court observed that the royalty interest "may be said, under our terminology dividing property into real and personal, to be one of a dual nature. It is not, then, perhaps surprising that some of the courts have, under particular circumstances, considered the right as personal property. Historically considered, the view is favored, we think, that it is an interest in real property . . . ."[28] The court further noted that "by the great weight of authority, especially as clarified by the decisions in the last decade, a royalty interest, at least if of a permanent nature, has been held to be real and not personal property . . . ."[29] The supreme court ultimately upheld the lower court's determination that the royalty interest was realty, and therefore passed to the plaintiff under the general words of conveyance.

The Wyoming court was next asked to decide the proper classification of a lesser interest in oil and gas. *Torgeson v. Connelly* involved an operating agreement with a primary term of twenty years and "so long thereafter as oil, gas, and other hydrocarbon substances are produced in commercial quantities."[30] The agreement purported to grant the exclusive right to drill on the land in accordance with a federal lease. The court was of the opinion that "(a)lthough this is less than the royalty interest previously considered by us and less even than an oil and gas lease, it in effect conveys a portion of the lease or the rights thereunder and constitutes real property."[31] After the *Torgeson* case it appears settled that oil and gas interests, at least those of potentially infinite duration, are real property in Wyoming.[32]

The realty-personalty distinction has been consequential in four main areas of Wyoming oil and gas law. The first

28. *Id.* at 845.
29. *Id.* at 848.
30. 348 P.2d 63, 69 (Wyo. 1959).
31. *Id.*
32. Indeed, eight years prior to *Torgeson*, the Supreme Court of Wyoming cited *Denver Joint Stock Land Bank v. Dixon* in support of the unqualified statement that "[o]il and gas interests in land are real property." Hageman & Pond, Inc. v. Clark, 69 Wyo. 154, 238 P.2d 919, 926 (1951).

and most obvious consequence of their classification as real property is that operating agreements, oil and gas leases, royalty interests, and mineral interests all fall within the statute of frauds.[33] Second, those interests are recordable interests within the purview of the Wyoming recording statutes, and as such must be recorded in order to be protected against a later purchaser in good faith and for value.[34] A third consequence of the realty-personalty distinction is illustrated by *Denver Joint Stock Land Bank v. Dixon*,[35] where the point in controversy was whether an interest in oil and gas passed by a mortgage of "real estate". As previously noted, there the Supreme Court of Wyoming based its holding that the royalty interest passed with the mortgage on its determination that such an interest is realty. Professors Williams and Meyers are critical of that approach; it is their view that "the classification of the royalty interest as realty or as personalty is properly of no significance in this context; the question is simply whether the royalty interest . . . is viewed as appurtenant to the land."[36]

The final area in which the realty-personalty distinction has had significance is taxation. The early case of *Miller v. Buck Creek Oil Co.*,[37] dealing with the relative obligations of the lessor and lessee to pay the gross products tax on oil and gas production, contained dictum to the effect that the tax was on property and was not a license, privilege or occupation tax. That case was later cited by the United States District Court for the District of Wyoming as evidence that the Supreme Court of Wyoming "leans toward the doctrine . . . that mineral when severed from the land becomes personal property and is taxable as such."[38] Any doubts were laid to rest in the case of *Oregon Basin Oil &*

33. *See, e.g.*, Montana & Western Oil Co. v. Gibson, 19 Wyo. 1, 113 P. 784 (1911); Hageman & Pond, Inc. v. Clark, 69 Wyo. 154, 238 P.2d 919 (1951); Oregon Basin Oil & Gas Co. v. Ohio Oil Co., 70 Wyo. 263, 248 P.2d 198 (1952).
34. *See, e.g.*, Denver Joint Stock Land Bank v. Dixon, *supra* note 8; Dame v. Mileski, 80 Wyo. 156, 340 P.2d 205 (1959); Note, *Recording Federal Oil and Gas Leases*, 15 WYO. L.J. 237 (1961).
35. *Supra* note 8.
36. 1 H. WILLIAMS & C. MEYERS, *supra* note 2, § 213.8.
37. 38 Wyo. 505, 269 P. 43 (1928).
38. First Nat'l Bank of Chicago v. Central Coal & Coke Co., 3 F. Supp. 433, 436 (D. Wyo. 1933).

Gas Co. v. Ohio Oil Co.[39] That action involved an oil and gas lease with a provision that the lessee was to pay all taxes assessed on the leased lands. When production was obtained, the lessee deducted from the account with the lessor a proportionate amount of the gross products tax levied on production. The lessor sued to recover that deduction, maintaining that the gross products tax was a tax upon realty, and therefore properly payable by the lessee under the express terms of the lease. The Wyoming Supreme Court rejected that position, holding that the gross products tax is a tax upon personalty.

II. THE PROTECTION OF INTERESTS IN OIL AND GAS

Having discussed the nature of ownership of oil and gas in Wyoming, and the various classifications of interests in those resources (and the consequences of such classifications), this writer will next trace the development of the law in protecting those interests in a variety of contexts.

Perhaps no opinion of the Wyoming Supreme Court in the field of oil and gas has engendered more controversy than its holding in the case of *Martel v. Hall Oil Co.*[40] That case concerned the liability of a trespasser to the owner of an interest in oil and gas for destruction of the speculative value of the interest. Martel, an oil and gas lessee, brought suit against a trespasser who had drilled a dry hole on the leased lands, thereby rendering the lease valueless. The supreme court acknowledged that a right had been violated, and the injured plaintiff was entitled to recovery of damages as shown. Martel claimed damages for the value of the interest as a speculation. In the now (in)famous language of that opinion, the court denied recovery of all but nominal damages,[41] stating:

> It may be, though there is no showing to that effect, that plaintiffs might have sold their rights for a considerable sum of money. They would then have

39. 70 Wyo. 263, 248 P.2d 198 (Wyo. 1952).
40. 36 Wyo. 166, 253 P. 862 (1927).
41. In an action arising out of the same trespass, Martel's lessor recovered for both surface damages and punitive damages. Hall Oil Co. v. Barquin, 33 Wyo. 92, 237 P. 255 (1925).

> been the gainers and the purchaser would have been the loser. They would, upon their own theory, have pocketed a lot of money, but for what? What would they have given in return? Nothing. They would have sold something of no value whatever . . . That a wealthy corporation might have been the purchaser furnishes no answer; it might have been a poor widow instead.[42]

The *Martel* case is often contrasted with the decision of the Texas Commission of Appeals in *Humble Oil & Refining Co. v. Kishi*,[43] in which the owner of the mineral interest was awarded damages equal to the full value of the interest as it was prior to the trespass and disclosure of non-productivity. It has been argued that the contrary results of the *Martel* and *Kishi* cases can be explained by factual differences. There was some evidence that Kishi could have leased the land for $1,000 an acre, while Martel could not show that there was any interest in his lease. Also, there was a producing well in close proximity to Kishi's land, though not so for Martel's lease.[44]

Professors Williams and Meyers are critical of both decisions,[45] *Kishi* because of the existence of liability without regard to the landowner's opportunity to realize upon the speculative value of the land; *Martel* because recovery is denied for the taking, without payment, of a privilege for which oil operators are often willing to pay large sums, i.e., the privilege of finding out for themselves whether the land is productive. It has been suggested that *Martel* notwithstanding, a Wyoming court might allow recovery of damages for trespass upon sufficient proof, as where it could be shown that the owner of the interest in oil and gas had a bona fide offer withdrawn because of the trespasser's acts.[46] Whatever the status of Wyoming law in this regard, the fact that no reported cases since *Martel* have turned on the issue there involved suggests that the problem has little lasting importance.

42. Martel v. Hall Oil Co., 253 P. at 866.
43. 276 S.W. 190 (Tex. Com. App. 1925); 291 S.W. 538 (Tex. Com. App. 1927), *on later appeal*, 299 S.W. 687 (Tex. Civ. App. 1927) (error ref'd).
44. Note, *Another Look at the Martel Case*, 11 WYO. L.J. 109, 110 (1957).
45. 1 H. WILLIAMS & C. MYERS, *supra* note 2, § 229.
46. Note, *supra* note 44, at 113.

Some of the problems involved in protection of interests in oil and gas arise as a consequence of the possibility of severing the mineral estate from the surface estate. Severance doctrine was first recognized in the case of *State ex rel. Cross v. Board of Land Comm'rs.* In that case, the court held that the Board of Land Commissioners had the authority to require that the mineral estate be conveyed to the state before patent would issue to the surface.[47] The doctrine was more fully developed in the case of *Ohio Oil Co. v. Wyoming Agency.*[48] Quoting from that opinion: "After severance, the two estates, owned separately, are held by separate and distinct titles . . . the two estates are 'as distinct as if they constituted two different parcels of land' . . . 'Each estate may be occupied, conveyed, incumbered, sold by the sheriff, or alloted in partition, without any effect upon the other.' "[49]

The *Ohio Oil Co. v. Wyoming Agency* case illustrates one effect of severance doctrine on the protection of interests in oil and gas. In that case, the defendant claimed title to the mineral estate by adverse possession of the surface estate. In rejecting that claim, the Wyoming Supreme Court stated that "(t)he authorities are unanimous in holding that where the surface and mineral estates have been severed, possession of the surface by its owner, cannot be adverse to the owner of the minerals, and that there can be no adverse possession of the severed mineral estate in the absence of mining operations."[50]

The rights of the owner of an interest in oil and gas are also affected by severance doctrine in the situation where the owner of the surface estate seeks to recover from the owner of the mineral estate for surface damages. The issue is of some importance in Wyoming, where stockraisers own thousands of surface acres, the federal government having reserved the rights to any oil and gas in the original patent.[51] Any development of the underlying minerals necessitates some use of and damage to the surface estate.

47. *Supra* note 7, at 428-31.
48. 63 Wyo. 187, 179 P.2d 773 (1947).
49. Ohio Oil Co. v. Wyoming Agency, 179 P.2d at 788.
50. *Id.* at 779.
51. Note, *Surface Damage Under a Federal Oil and Gas Lease,* 11 WYO. L.J. 116 (1957).

The respective rights of the owners of the surface and mineral estates were adjudicated in the early case of *Kinney-Coastal Oil Co. v. Kieffer*,[52] which arose in the United States District Court for Wyoming and whose decision was affirmed by the United States Supreme Court.

In that case, an oil and gas lessee sought to enjoin the owner of the surface estate from establishing a townsite in an area where one well had obtained production, and further development would require much of the surface. In granting the injunction, the Supreme Court held that the mineral estate had a statutory servitude on the surface estate to permit extraction of the oil and gas, which would be defeated by the establishment of a townsite thereon. The Court also stated that, in the absence of proof of negligent mining operations, surface owners can recover only for damages to agricultural improvements or agricultural crops.[53]

The latter part of the *Kieffer* holding proved significant in the case of *Holbrook v. Continental Oil Co.*[54] There the plaintiff, owner of the surface, sought, among other things, to recover for damage to natural grazing grasses caused by defendant's drilling operations. The Wyoming Supreme Court upheld the trial court's denial of compensation on the ground that natural grasses are not "crops" as that word had been defined in *Kieffer*. Since defendant's use of the surface for drilling installations and the construction of dwelling house was "reasonably incident" to removal of oil and gas, the plaintiff's various claims were not valid under the federal statutes there involved.[55]

52. 277 U.S. 488 (1928).
53. *Id.* at 505. This was an interpretation of the Agricultural Entry Act of 1914, which provided that the surface owner was entitled to recover damages for injury to "crops"; the Court's holding defined "crops" as those of agricultural nature. *Id.*
54. 73 Wyo. 321, 278 P.2d 798 (1955).
55. *Id.* at 803, 805-06.
> The courts have determined numerous acts by the lessee as being reasonably incident to oil and gas operations. Use of the surface for drill sites, sumps, tanks, roads, pipe lines, water lines and the use of heavy machinery are but a few of the many operations conducted by the lessee causing extensive surface damage for which the stockraiser is not compensated.

Note, *supra* note 51, at 117. *See also* Thompson, *Surface Damages—Claims By Surface Estate Owner Against Mineral Estate Owner*, 14 WYO. L.J. 99 (1960); Brimmer, *The Rancher's Subservient Estate*, 5 LAND & WATER L. REV. 49 (1970).

Previous sections of this paper have dealt largely with the few areas of oil and gas law that have been fairly well developed by the Wyoming courts. This overview would not be complete without some mention of a number of related issues for which there is little or no clear authority found in the reported decisions of the courts of that state.

One such area is the status of implied covenants in oil and gas leases in Wyoming. The existence of implied covenants has been the subject of a substantial amount of litigation in other jurisdictions, where courts are forced to determine the nature of the lessee's duties in connection with exploration, development and operation, absent a stipulation in the lease itself.[56] However, no opinion of the Wyoming Supreme Court has ever turned on the question whether covenants could be implied in a lease.[57] The reason for the lack of case law in this area is not clear. At one time there existed a statutory bar to implied covenants in any conveyance of real estate,[58] but that possible barrier has since been removed.[59] It has been suggested that the widespread acceptance of implied covenants in other states has caused potential litigants to assume their existence in Wyoming law.

Another area in which the development of law in Wyoming has trailed other states is the construction of ambiguous language in instruments granting or reserving interests in oil and gas. For example, an extremely important issue arises when such a conveyance uses the word "minerals" only, with no mention of oil and gas specifically. Surprisingly, the Wyoming Supreme Court has not had to decide whether the term "minerals" includes oil and gas for such purposes. The problem was finally dealt with in 1978 by the United States District Court for the District of Wyo-

56. Covenants frequently implied in other jurisdictions include the implied covenant to protect from drainage and the implied covenant of reasonable development. *See generally* 5 H. WILLIAMS & C. MEYERS, *supra* note 2, ch. 8.
57. A few Wyoming cases contain scattered references to implied covenants, but their existence (or non-existence) was not essential to the holdings therein. *See, e.g.*, Phillips v. Hamilton, 17 Wyo. 41, 95 P. 846 (1908); Pryor Mountain Oil & Gas Co. v. Cross, 31 Wyo. 9, 222 P. 570 (1924). *See also*, Cooper v. Ohio Oil Co., 108 F.2d 535 (10th Cir. 1939).
58. Note, *A Possible Bar to Implied Covenants in Wyoming Oil and Gas Leases*, 11 WYO. L.J. 57 (1956).
59. Note, *supra* note 10, at 85 n.37.

ming in *Amoco Production Co. v. Guild Trust.*[60] That case involved a 1909 deed which reserved to the grantor "[a]ll coal and other minerals within or underlying said lands" and associated rights of entry and surface use.[61] The court's opinion noted that "(a)lthough the Supreme Court of Wyoming has not ruled on this type of reservation, many state and federal courts have. The great weight of authority establishes that this language unambiguously includes oil and gas and is effective to sever the entire mineral estate."[62] On appeal, the District Court's holding was affirmed, the Circuit Court expressly adopting the analysis of the trial court.[63]

There are many other areas—the deed-lease distinction, double fraction problems, and allocation of production expenses, to name a few—in which Wyoming law is, at best, partially developed. Suffice it to say that, whatever the reasons, a large part of the law of oil and gas in Wyoming remains an open book.

III. SPACING, POOLING AND UNITIZATION

Not surprisingly, the focus of oil and gas law has shifted in recent years to efforts to conserve those resources. Effective conservation entails a sometimes difficult balancing of opposing interests. Occupying one side of the scale is the interest of the state in maximizing recovery of natural resources through avoidance of wasteful practices. Taken to an extreme, maximum efficiency would demand the development of a whole common source of supply without regard to surface boundaries of overlying tracts. Countervailing the state's interest in conservation are the interests of the many mineral owners in a particular pool to "capture" their fair share of any oil and gas therein before it is drained by the other owners—or, in the jargon of the trade, to assert their "correlative rights." The ensuing "race to the pumps" is

60. 461 F. Supp. 279 (D. Wyo. 1978).
61. *Id.* at 280.
62. *Id.* at 281.
63. Amoco Production Co. v. Guild Trust, 636 F.2d 261 (10th Cir. 1980); *see also* Guild Trust v. Union Pacific Land Resources Corp., 475 F. Supp. 726 (D. Wyo. 1979); Union Pacific Land Resources Corp. v. Moench Investment Co., 495 F. Supp. 876 (D. Wyo. 1980).

extremely wasteful, both in terms of money expended on unnecessary wells, and in the significant amount of oil and gas rendered unrecoverable as pressure is lost due to excessive drilling. One writer has stated the dilemma as follows: "The law recognizes that many parties may have property interests in a reservoir of oil and gas; but the petroleum engineers describe such a reservoir as a single mechanical unit and insist that it can be efficiently developed only as a whole."[64]

The Wyoming Legislature has long had a hand in controlling waste of that state's natural resources. One of the early Wyoming cases to make its way to the United States Supreme Court involved a challenge to the constitutionality of a Wyoming statute which outlawed certain wasteful uses of natural gas. In *Walls v. Midland Carbon Co.*,[65] the Court upheld the state's power to "adjust and preserve" one of its natural resources. At that early date, authority to make rules and regulations governing the operation and production of oil and gas in Wyoming was vested in the Commissioner of Public Lands. It was not until 1951 that the state enacted a comprehensive conservation statute, the Oil and Gas Conservation Act. With some minor amendments and major additions, that Act remains in operation to this date.[66]

Before discussing the provisions controlling well spacing, pooling and unitization in some detail, it should be helpful to summarize the various other features of the Act. The basic mandate of the statute is ambitious indeed: "The waste of oil and gas or either of them in the state of Wyoming as in this act defined is hereby prohibited."[67] The definition of "waste" is quite broad, listing physical waste, inefficient dissipation of reservoir energy, inefficient storing of oil or gas, and several other improper activities.[68] The body charged with administration of the Act is the Oil and Gas Conservation Commission, composed of the Governor,

64. Junger, *The Wyoming Oil and Gas Conservation Act*, 13 WYO. L.J. 1, 3 (1953).
65. 254 U.S. 300 (1920).
66. WYO. STAT. §§ 30-5-101 to -104, 30-5-108 to -119 (1977).
67. *Id.* § 30-5-102(a).
68. *Id.* § 30-5-101(a)(i).

the Commissioner of Public Lands, the State Geologist, and two members appointed by the Governor from the public at large.[69] Also created is the office of Oil and Gas Supervisor, who is ex officio the Director and Secretary of the Commission.[70] The Commission is vested with a wide range of powers, including authority to allocate allowable production,[71] to require a wide variety of information from producers and to regulate drilling operations;[72] all in addition to a general power to "make rules, regulations, and orders . . . to effectuate the purposes and intent" of the Act.[73] The Commission is specifically empowered to summon witnesses, administer oaths, and require the production of all types of records for its hearings.[74] Persons who violate the various provisions of the Act are subject to suit brought by the Commission,[75] and may be civilly or criminally liable.[76]

Section 30-5-117 of the statute, which bears the heading "Construction of act generally", contains the following limitation on the Commission's authority:

> It is not the intent or purpose of this law to require, permit, or authorize the commission or supervisor to prorate or distribute the production of oil and gas among the fields of Wyoming on the basis of market demand. This act shall never be construed to require, permit or authorize the commission, the supervisor, or any court to make, enter or enforce any order, rule, regulation or judgment requiring restriction of production of any pool or of any well except to prevent waste and to protect correlative rights.[77]

In the original 1951 version of what is now Section 30-5-117, that second sentence read much differently: "This act shall never be construed to require, permit or authorize the Commission . . . to make . . . any order . . . requiring restriction of production of any pool or of any well . . .

69. *Id.* § 30-5-103(a).
70. *Id.* § 30-5-103(d).
71. *Id.* § 30-5-102(b).
72. *Id.* § 30-5-104(d).
73. *Id.* § 30-5-104(c).
74. *Id.* § 30-5-112.
75. *Id.* § 30-5-114.
76. *Id.* § 30-5-119.
77. *Id.* § 30-5-117.

to an amount less than the well or pool can produce in accordance with sound engineering practice."[78] It has been argued that the original wording of that section contradicted the intent of the Act, since some types of waste (e.g., the flaring of gas) can be committed even though the well itself violates no practice of good engineering.[79] A 1971 amendment removed the inconsistency and brought the section to its present form.

As originally enacted, the conservation statute was also criticized for not giving the Commission the power to protect the correlative rights of owners over a common pool.[80] The Act was amended in 1971 to provide that "[w]hen required, to protect correlative rights . . . the commission . . . shall have the power to establish drilling units of specified and approximately uniform size covering any pool."[81] Section 30-5-102 of the Act, as amended, defines "correlative rights" as "the opportunity afforded the owner of each property in a pool to produce, so far as it is reasonably practicable to do so without waste, his just and equitable share of the oil or gas, or both, in the pool."[82]

78. 1951 Wyo. Sess. Laws ch. 94, § 14 (emphasis added).
79. Junger, *supra* note 64, at 7. Interestingly, the hypothetical chosen by the author of that article to illustrate a potential problem with the original wording of the statute was actually litigated in the case of Inexco Oil Co. v. Oil & Gas Conservation Comm'n, 490 P.2d 1065 (Wyo. 1971). In that case, Inexco was involved in the flaring of gas which could not be economically saved and used at the time it was produced. The Commission cut back on Inexco's allowable production in an effort to curtail consumption of the gas in that manner. The sole issue before the Supreme Court of Wyoming was whether the Commission had authority to restrict production from Inexco's oil wells under those circumstances. That the operation of the wells themselves was in accordance with sound engineering practices was not contested by the Commission. Inexco pointed out that the definition of waste in effect at that time specifically excluded flaring of gas unavoidably produced with oil if it is not economically feasible for the producer to save or use such gas. In a somewhat confused opinion, the court upheld the Commission's actions, reading the 1971 amendment (which was passed during the course of the litigation) as making it clear that "in order to prevent waste conservation measures were permissible." 490 P.2d at 1068.
80. Junger, *supra* note 64, at 42.
81. WYO. STAT. § 30-5-109(a) (1977).
82. The argument has been made that the provision that the Commission must protect correlative rights imposes no greater obligation than had previously existed at common law. Jones, *Protection of Correlative Rights in Wyoming*, 3 LAND & WATER L. REV. 363, 375 (1968).
> Correlative rights exist as common law rights against (1) the waste of extracted substances, (2) spoilage of the common reservoir, (3) malicious depletion of the common source of supply, and (4) as the right to extract a fair share of the oil or gas. Any abridgement of

A. *Well Spacing*

The well spacing provisions of the Wyoming Oil and Gas Conservation Act are based on the premise that it only takes one oil well to efficiently drain a certain area. In the previously cited section authorizing the Commission to establish drilling units, a later provision demands that "(i)n establishing a drilling unit, the acreage to be embraced within each unit and the shape thereof . . . shall not be smaller than the maximum area that can be efficiently drained by one (1) well."[83] Those directives are implemented roughly as follows:[84]

In the usual case, there are a variety of ownership interests in a given pool, ranging from parties working under an operating agreement to owners of the mineral estate in fee. When an operator discovers a new source of oil or gas, he immediately applies to the Commission for a spacing order. In that initial application, the operator must express his best estimate of the areal limits of the pool. Following the application, a spacing hearing is held by the Commission, at which time the other overlying owners may, and frequently do, contest the application. A common issue is the selection of the appropriate spacing pattern for the particular field—80 acre- v. 160-acre spacing; 320 acre- v. 640-acre spacing, etc. Expert testimony is heard from all sides. Within thirty days after the hearing a spacing order is issued by the Commission, and development of the new field can proceed.

Usually, the Commission's initial spacing order is temporary. As development of the new field reveals more definitely the extent of the pool, the Commission may reconvene to review its previous spacing order. As a result of that second hearing, the size of the spaced area may be reduced.

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these rights by the legislature amounts to a taking of private property for which compensation must be paid.

Id.

83. WYO. STAT. § 30-5-109(b) (1977).

84. *See generally* Williams & Porter, *Practice Before the Wyoming Oil and Gas Conservation Commission*, 10 LAND & WATER L. REV. 353, 368-75 (1975).

As has been discussed, the interest of the Commission in avoiding waste of oil and gas through efficient spacing may clash with the interests of the overlying owners in asserting their correlative rights. For example, it may be that the location of a well at the spot mandated by the spacing order would yield a dry hole; but if the owner were allowed to drill elsewhere on his tract production would be obtained. The Commission has attempted to provide for a proper balancing of those interests through the adoption of two rules. Rule 302 requires oil and gas wells to be located in the center of a 40-acre parcel; subject, of course, to the Commission's prerogative to opt for larger or smaller drilling units, where appropriate. Rule 303 authorizes applications for an exception to the restrictions of Rule 302.[85] "[That] provision for an exception, while not expressly mentioning correlative rights, is involved in a correlative rights question . . . [I]f the only way a lessor or lessee may recover the oil underneath a given tract is to allow a well to be drilled, then the Commission is authorized to grant such an exception to a spacing order . . . ."[86]

The propriety of Commission practices in applying Rules 302 and 303 was at issue in the case of *Pan American Petroleum Corp. v. Wyoming Oil & Gas Conservation Comm'n.*[87] Pan American had applied for an exception to the Commission's spacing rules. That application was successfully challenged by Marathon Oil Company; the Commission held that the granting of an exception was not necessary to protect Pan American's correlative rights, since Pan American's existing wells would adequately drain the oil in their tract. Pan American alleged that since the field, of which its tract was part, had been substantially developed prior to the enactment of the conservation statute, that Act and the operational rules thereunder should not apply. The constitutionality of applying Rule 302 retroactively was also challenged. The Wyoming Supreme Court

85. Rules 302 and 303 of the Rules and Regulations of the Wyoming Oil and Gas Comm'n represent the Commission's efforts to implement two parts of the statute: WYO. STAT. § 30-5-109(b), (c) (1977).
86. Williams & Porter, *supra* note 84, at 374.
87. 446 P.2d 550 (Wyo. 1968).

did not pass on Pan American's allegations, but returned the entire matter to the Commission for reconsideration, stating:

> . . . [W]e think those matters [relating to the constitutionality of Rule 302] must be deferred for the reason that we find it necessary to return this proceeding to the commission for further consideration of the factual issues tendered pursuant to Rule 303 which in substance is an "escape hatch" to claimed infringement of property rights by Rule 302. Until the commission disposes of these matters in keeping with the directions of this court . . . any effort now to pass upon the foregoing claimed errors would be premature. Counsel, we are sure, are well aware of the fundamental rule that courts do not pass upon constitutionality of statutes unless the necessity therefore clearly appears.[88]

Two years later, the names had changed but the problems remained. In *Marathon Oil Co. v. Pan American Petroleum Corp.*,[89] the Commission had, on rehearing, adhered to its position that Rule 302 was controlling and again denied Pan American's application for exception to the spacing provisions. The district court reversed that decision, holding Rule 302 invalid as applied to the particular field in question. In upholding the determination of the district court, the Supreme Court of Wyoming added: "The Commission's Rule 302 utterly and completely disregards the circumstances present in a field which was developed prior to the adoption of such rule, where wells were not drilled at the center of 40-acre subdivisions of land. If it were not for Rule 303, it would be unreasonable and arbitrary for the Commission to apply Rule 302 to [such a field]."[90] The court concluded that the Commission had not made findings of fact sufficient to justify its denial of Pan American's application for an exception.

More recently, in *Larsen v. Oil & Gas Conservation Comm'n.*,[91] the Commission's action in ordering 80-acre

88. *Id.* at 554.
89. 473 P.2d 575 (Wyo. 1970).
90. *Id.* at 577.
91. 569 P.2d 87 (Wyo. 1977).

spacing in a field was challenged, where there was substantial evidence that plaintiff's well was already efficiently draining a much larger area. The Wyoming Supreme Court observed that under the statute, before a drilling unit can be established, the Commission must first find that such a unit is necessary to protect correlative rights or to prevent waste.[92] Once that determination is made, the Commission must decide on the size of the unit, but each unit "shall not be smaller than the maximum area that can be efficiently drained by one (1) well."[93] The court noted that the Commission's findings of fact in the case made absolutely no mention of plaintiff's correlative rights, nor was the amount of oil that could be recovered without waste indicated. The case was remanded for further findings of fact with the directive that, in order to determine the extent of the correlative rights in question, the Commission must establish ("insofar as it is reasonably practicable to do so") the following: (1) the amount of recoverable oil in the pool; (2) the amount of recoverable oil under the various tracts; (3) the proportion that #1 bears to #2; and (4) the amount of oil that can be recovered without waste.[94]

In dicta, the court criticized the Commission's misinterpretation of certain legal standards. Specifically, the court found fault with the wording of one of the Commission's "conclusions of law" in the case, which stated that the drilling of additional wells in a certain pool would constitute "economic and physical" waste. The court pointed out that "economic" waste was not among the types of waste embraced by the statute; that, indeed, the legislature had considered and rejected language which would have brought "the drilling of wells not reasonably necessary to effect an economic maximum ultimate recovery of oil and gas from

92. WYO. STAT. § 30-5-109(a) (1977) provides:
When required, to protect correlative rights or, to prevent or to assist in preventing any of the various types of waste of oil or gas prohibited by this act, or by any statute of this state, the commission, upon its own motion or on a proper application of an interested party, but after notice and hearing as herein provided shall have the power to establish drilling units of specified and approximately uniform size covering any pool.

93. *Id.* § 30-5-109(b).

94. Larsen v. Oil & Gas Conservation Comm'n, *supra* note 91, at 92.

a pool" within the definition of waste. The court warned the Commission that "[in making] an ultimate finding concerning waste, in this and similar considerations, it should do so only on the basis of the various types of waste enumerated in [the statute]."[95] That statement appears to directly contradict the court's previous holding in the *Inexco* case.[96]

The *Larsen* case has engendered a good deal of controversy among oil and gas practitioners. It has been suggested that given limits of the technical capacity of the oil and gas industry to estimate, with any degree of confidence, the amount of recoverable oil or gas underlying any portion of a given reservoir, the holding in *Larsen* imposes on well spacing applicants a burden of proof which they are incapable of sustaining.[97] Moreover, it appears that the *Larsen* holding is based upon a New Mexico case, *Continental Oil Co. v. Oil Conservation Comm'n.*,[98] which involved the application of a New Mexico conservation law authorizing the establishment of market demand proration units, even though Wyoming conservation law explicitly prohibits limiting production on the basis of market demand.[99] Finally, it should be noted that following the court's holding in *Larsen*, the Wyoming legislature amended the statutory powers conferred upon the Commission to include authority to establish drilling units affording each owner "an opportunity to drill for and produce *as a prudent operator*, and so far as it is *reasonably practicable* to do so without waste, his just and equitable share of the oil or gas or both in the pool. . . ."[100] (Emphasis supplied). The effect of the new language should be to allow the Commission to act with an eye toward the economic and technical limitations imposed upon the oil and gas industry.

95. *Id.* at 93.
96. *See supra* note 79.
97. Newman, *Practice Before State Oil and Gas Agencies*, 1981 NAT. RESOURCES AD. L. & PROC. INST. 38.
98. 70 N.M. 310, 373 P.2d 809 (1962).
99. WYO. STAT. § 30-5-117 (1977).
100. *Id.* § 30-5-104(d)(iv) (Cum. Supp. 1981).

B. *Pooling*

Once a spacing order is entered by the Commission, and depending upon the size of the drilling unit chosen, there may exist individual tracts which are too small to qualify for a well under the terms of the order. To bar the owner of such a tract from extracting the oil and gas under his land would constitute a denial of his correlative rights. On the other hand, the tract may be so small that the cost of drilling a well exceeds the value of the underlying resources. Pooling statutes are designed to solve that dilemma by combining the smaller tracts into an area large enough to justify the drilling of a well, with costs and benefits of the operation to be apportioned among the pooled interests.

The Oil and Gas Conservation Act provides for pooling (also referred to as communitization) both on a voluntary basis, and by order of the Commission if a voluntary agreement cannot be reached. A pooling order can be made only after notice and hearing, and must be upon terms and conditions that are "just and reasonable."[101]

In the easiest case, the owners of oil and gas interests in the various smaller tracts enter into a pooling agreement. Details such as the location of the well, the costs to be borne by each of the parties and the allocation of any oil and gas produced are worked out by the interested parties themselves. Drilling can then proceed in accordance with the spacing order.

The harder case arises when one or more of the owners of mineral interests in the drilling unit refuses to enter into a pooling agreement voluntarily. In such a case, upon the application of any interested person, the Commission may enter an order pooling all interests in the drilling unit. The statute provides a substantial incentive for voluntary agreements, as nonconsenting owners pay a heavy penalty for their refusal to coalesce. The penalty is built into the section of the Act which empowers the Commission to apportion drilling and operating costs among the parties covered by the pooling order. That section provides that nonconsenting

101. WYO. STAT. § 30-5-109(f) (1977).

owners may be charged for two hundred percent of certain costs associated with the well, to be deducted from such nonconsenting owners' share of production.[102] A potential party to a pooling agreement is thus faced with a choice. If he chooses to enter the agreement voluntarily, he will undoubtedly have to contribute to the costs of drilling the well out of pocket. If he chooses to withhold his consent he escapes the out-of-pocket expenses, but risks having to pay twice his share of certain costs out of production, should the Commission enter a pooling order. Of the many variables which may figure in that decision, probably the most important is the likelihood of the presence of oil or gas beneath the drilling unit.

The mandatory two hundred percent nonconsent penalty has been subject to some criticism. Under the terms of the Wyoming statute, no discretion is given to the Commission to vary the penalty from case to case. Professors Williams and Meyers have expressed a "lack of enthusiasm for a rule that says, in every case, without regard to the degree of risk, the price of refusal to share in drilling costs at the outset is 200 per cent of those costs if the well comes in."[103] The professors would prefer a rule giving the Commission discretion to adjust the amount of the penalty according to the facts of the case, subject to a two hundred percent ceiling.

There is surprisingly little case law dealing with the pooling statute. In *Mitchell v. Simpson*,[104] The only issue was jurisdiction. The Commission had entered an order for pooling of the tracts in a certain drilling unit; the nonconsenting party, Simpson, was the owner of a royalty interest in one of those tracts. The trial court had granted

102. *Id.* § 30-5-109(g)(ii).
> Two hundred percent (200%) of that portion of the costs and expenses of drilling, reworking, deepening or plugging back, testing and completing, after deducting any cash contributions received and two hundred percent (200%) of that portion of the cost of newly acquired equipment in the well (to and including the wellhead connections), which would have been chargeable to such nonconsenting owner if it had participated therein.

Id.

103. Williams & Meyers, *Petroleum Conservation in Ohio*, 26 OHIO ST. L.J. 591, 611 (1965).

104. 493 P.2d 399 (Wyo. 1972).

Simpson's motion for summary judgment, holding that royalty owners are not within the Commission's jurisdiction for pooling purposes. The Supreme Court of Wyoming reversed that holding, quoting the language of the statute that "[i]n the absence of voluntary pooling, the commission, upon the application of any interested person, may enter an order pooling *all interests* in the drilling unit for development and operation thereof."[105] (Emphasis in original). Furthermore, the court referred to another section of the statutes which gives the Commission "jurisdiction and authority over all persons and property, public and private, necessary to effectuate the purposes and intent of this act."[106] The supreme court found, in the above quoted language, ample support for the Commission's claim of jurisdiction over royalty owners. By this writer's research, *Mitchell v. Simpson* is the only reported case dealing with Wyoming's pooling provision to date.

C. *Unitization*

As previously discussed, the concern of Wyoming's pooling provision is to reconcile the objectives of well spacing with the special problems of small tract owners. Ideally, the pooling provision allows for the efficient development of a new field, while protecting the correlative rights of the overlying owners.

That is not to say that optimal well spacing will necessarily result in maximum recovery of oil and gas from a given pool. To achieve that goal, other activities may be necessary, such as pressure maintenance and secondary recovery operations. To be effective, those activities will often require unitary operation of the field.[107] In some cases, there may be nonconsenting owners, so that a voluntary unitization agreement is impossible. In response to such a situation, many states have enacted statutes providing for "compulsory" unitization; "compulsory" only in the sense that if a

105. *Id.* at 402 (emphasis in original).
106. *Id.*
107. It is important to distinguish between "pooling" and "unitization". Pooling involves the comminitization of small tract owners to yield the areal equivalent of a drilling unit; unitization is the communitization of all interests in a given pool.

super majority of the interests in a field favor unitization, the state commission is empowered to override the objections of the nonconsenting minority.

The Wyoming provision is typical in that regard. To be effective, a plan of unitization must be approved by the owners of at least eighty percent of the cost-bearing interests and by the owners of a like percentage of any cost-free interests.[108] Commission procedure in entering a compulsory unitization order is much the same as for well spacing. Any interested person may apply for an order compelling unitization. The application must provide a variety of information, including a description of the pool, the names of persons owning interests therein, and "a statement of the type of operations contemplated in order to effectuate the purposes of this act."[109] Following the application, the Commission must hold a hearing, with adequate notice. In order to justify a plan for unitization, evidence gathered at the hearing must substantiate the following findings:

(1) Unit operation is feasible, will prevent waste, will protect correlative rights, and can reasonably be expected to increase substantially the ultimate recovery of oil or gas.

(2) The value of the estimated additional recovery of oil or gas will exceed the estimated additional costs of unit operations.

(3) The unit plan will allocate a just and reasonable share of the oil or gas produced to each separately owned tract.

(4) The unit plan allocates costs of unit operations to the various owners in a manner which is fair and equitable.[110]

108. WYO. STAT. § 30-5-110(f) (1977).

109. *Id.* § 30-5-110(c). Permissible operations are listed at § 30-5-110(a) as follows:

> waterflooding or other recovery operations involving the introduction of extraneous forms of energy into any pool, repressuring or pressure maintenance operations, cycling or recycling operations, including the extraction and separation of liquid hydrocarbons from natural gas in connection therewith, or for carrying any other method of unit or cooperative development or operation of one (1) or more pools or parts thereof. . . .

110. *Id.* § 30-5-110(e). For a detailed analysis of the various sections of the unitization statute, see Gray & Swan, *Fieldwide Unitization in Wyoming*, 7 LAND & WATER L. REV. 433 (1972).

If evidence adduced at the hearing is sufficient to justify those findings, and provided that the requisite eighty percent approval from interest owners has been received, the Commission is empowered to order unitization as requested.[111]

As a practical matter, the need for a compulsory unitization statute in Wyoming appears to be marginal. Although such provisions were enacted in several of the oil and gas-producing states during the 1950's, the Wyoming Legislature did not see fit to adopt such a statute until 1971. Since that time, no reported case has dealt directly with the various sections of the Wyoming statute. The main reason for the lack of litigation in the area is probably the fact that virtually all owners recognize unit agreements as being in their own best interests. Little compulsion is needed where, as in Wyoming, "companies have uniformly taken the position that all interest owners should voluntarily execute unit agreements."[112]

111. In 1980, the Wyoming legislature amended the applicable statute to provide that the Commission may reduce the required percentage of approval from 80% to 75%, in situations where the applicant has participated in negotiations "diligently and in good faith" for a period of at least nine months prior to the filing of the application. WYO. STAT. § 30-5-110(f) (Supp. 1981).

112. Williams & Porter, *supra* note 84, at 394.