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COMMENTS

APPEALS FROM PRORATION ORDERS FOR SMALL TRACT WELLS

by *David G. McLane*

I. INTRODUCTION

A fundamental and pervasive influence in the oil and gas industry is the promulgation and implementation of conservation laws,¹ legislative restrictions on the basic Rule of Capture.² In Texas such a program is administered by the Railroad Commission (termed the Commission herein) by means of spacing and production regulations. The problem arising from a small tract well is important in both facets of conservation and poses additional difficulties in protecting correlative rights within a reservoir. Much of the uncertainty in these areas has been minimized by the enactment of the "Mineral Interest Pooling Act,"³ which became effective August 30, 1965. However, the judicial law in this connection continues to apply both directly, in situations not within the purview of the statute,⁴ and indirectly, as a basis for interpretation of the statute. In this latter regard, it must be emphasized that Texas was one of the last two major petroleum-producing states without a compulsory pooling statute⁵ and that an important stimulus for its enactment was the case law development. The Pooling Act was not traumatic in origin or effect but rather the natural product of an evolutionary process which began in the courts. The statute's contribution was to clarify and define

¹ These have been held constitutional by the United States Supreme Court in *Ohio Oil Co. v. Indiana*, 177 U.S. 190 (1900) (antiflaring statute) and by the Texas Supreme Court in *Brown v. Humble Oil & Ref. Co.*, 126 Tex. 296, 83 S.W.2d 935 (1935). See also Annot., 99 A.L.R. 1119 (1935).

² See text following note 67.

³ This compulsory pooling statute was enacted by the legislature on February 24, 1965, and signed by Governor Connally on March 4. It will be hereinafter referred to as the "Pooling Act." Unless otherwise indicated, "section" references are to sections of Vernon's Tex. Sess. Law Serv., ch. 11, at 24 (1965), to be Tex. Rev. Civ. Stat. Ann. art. 6008C (1965).

⁴ Section 2(f) of the Pooling Act expressly excludes pre-*Normanna* pools (prior to March 8, 1961) from its province. There appears to be no reason why large-tract owners could not utilize the statute to pool a small tract, although no express authorization to that effect exists. If for some reason the Pooling Act were interpreted as being exclusively for use by the small tract owner, the importance of case law in this area would be but little diminished.

⁵ Only Kansas now remains.

the law which was already substantially in existence, and it should be interpreted in that light.

Before the Pooling Act this small tract problem was handled by means of both spacing (Rule 37 exception permits⁶) and allowable regulation, creating a complicated system for resolving conflicting interests. Significant decisions affecting this unique aspect of oil and gas law have been handed down recently by the Supreme Court of Texas, and a number of questions have been resolved. It should be remembered that both methods of dealing with the small tract problem are administered by the Commission.

II. THE RAILROAD COMMISSION

A. *Constitutional And Statutory Genesis*

Article XVI, Section 59(a) of the Texas Constitution directs the legislature to do whatever is necessary for the "conservation and development of all of the natural resources of this State. . . ." In 1891 the Railroad Commission of Texas was established by constitutional amendment, and its present powers are enunciated in the statutes.⁷ The power of the legislature to delegate enforcement powers to an administrative agency such as the Commission, after promulgating the basic conservation rules, has been upheld repeatedly.⁸

B. *Scope Of Authority*

The Commission possesses the exclusive authority to administer the oil and gas conservation regulations of the state, but only to prevent waste and protect correlative rights.⁹ Railroad Commission orders generally will be upheld if they reasonably relate to those objectives,¹⁰ are supported by "substantial evidence,"¹¹ and are not

⁶ See discussion in text accompanying notes 26-46 *infra*.

⁷ Tex. Rev. Civ. Stat. Ann. arts. 6004-6066(d) (1962). The Commission has the power to "make and enforce rules, regulations, or orders for the conservation of natural gas, to prevent the waste thereof, and otherwise to accomplish the purposes of this Article . . ." Tex. Rev. Civ. Stat. Ann. art. 6008, § 6 (1962).

⁸ *James v. Trustees of Eagle Pass Independent School Dist.*, 376 S.W.2d 956 (Tex. Civ. App. 1964); *Harris v. Municipal Gas Co.*, 59 S.W.2d 355 (Tex. Civ. App. 1933) *error dismissed*; *Gulf C. & S.F.R.R. v. State*, 120 S.W. 1028 (Tex. Civ. App. 1909) *error ref.* A legislative delegation of rulemaking authority must fix definite standards in order to be valid. *Southwestern Sav. & Loan Ass'n v. Falkner*, 160 Tex. 417, 331 S.W.2d 917 (1960). Delegation of authority is not unlawful where standards for exercise of discretion, though general, are capable of reasonable application. *Nichols v. City of Dallas*, 347 S.W.2d 326 (Tex. Civ. App. 1961) *error ref. n.r.e.*

⁹ *Railroad Comm'n v. Continental Oil Co.*, 157 S.W.2d 695 (Tex. Civ. App. 1941) *error ref.*; Tex. Rev. Civ. Stat. Ann. art. 6008, § 10 (1962).

¹⁰ *Railroad Comm'n v. Continental Oil Co.*, note 9 *supra*.

¹¹ *Thompson v. Consolidated Gas Util. Corp.*, 300 U.S. 55 (1937); *Railroad Comm'n v. Manziel*, 361 S.W.2d 560 (Tex. 1962); *Railroad Comm'n v. Shell Oil Co.*, 146 Tex. 286, 206 S.W.2d 235 (1947); *Trapp v. Shell Oil Co.*, 145 Tex. 323, 198 S.W.2d 424 (1946); *Railroad Comm'n v. Fain*, 161 S.W.2d 498 (Tex. Civ. App. 1942) *error ref.*

otherwise arbitrary, discriminatory, or unjust.¹² Except with respect to compulsory units under the Pooling Act, the Commission maintains continuing jurisdiction to amend or revoke prior orders and to substitute new regulations therefor should conditions so demand.¹³ The Commission has the power and duty "to inquire into the production, storage, transportation, refining, reclaiming, treating, marketing or processing of crude petroleum oil and natural gas . . . in order to determine whether or not waste exists or is imminent, or whether the oil and gas conservation laws of Texas . . . are being violated."¹⁴ Furthermore, upon verified complaint of any interested party that waste is taking place or is "reasonably imminent," the Railroad Commission may hold a hearing and, if it agrees, "shall make such rule, regulation or order as in its judgment is reasonably required to correct, prevent or lessen such waste."¹⁵

C. Judicial Review Of Commission Proceedings

Section 8 of article 6049c allows any interested person to sue "in a Court of competent jurisdiction in Travis County, Texas," against the Railroad Commission "to test the validity of said laws, rules, regulations or orders."¹⁶ Under the Pooling Act, however, venue lies in the district court of the county in which the land or any part thereof is located, notwithstanding the aforementioned section.¹⁷ Although the Supreme Court of Texas can also review Commission rules regulating the production of oil and gas, neither court can substitute its judgments or standards for those of the agency.¹⁸ The Commission's laws, rules, orders and regulations are presumed valid, the burden of proving their invalidity falling upon the complaining party.¹⁹ With respect to the prevention of waste,

the Commission should be left reasonably free to exercise its sound judgment and discretion. The Commission should bear in mind, how-

Texas employs a hybrid of the usual substantial evidence rule in that the court, in reviewing the order, is not limited to reviewing only the record made in the Commission's hearing below, but may entertain new evidence at the trial court level.

¹² *Thompson v. Consolidated Gas Util. Corp.*, 300 U.S. 55 (1937); *Brown v. Humble Oil & Ref. Co.*, 126 Tex. 296, 83 S.W.2d 935 (1935).

¹³ See notes 134-36 *infra* and accompanying text.

¹⁴ Tex. Rev. Civ. Stat. Ann. art. 6049c, § 5 (1962).

¹⁵ Tex. Rev. Civ. Stat. Ann. art. 6049c, § 7 (1962).

¹⁶ Tex. Rev. Civ. Stat. Ann. art. 6049c, § 8 (1962).

¹⁷ Section 2(g).

¹⁸ *Atlantic Ref. Co. v. Railroad Comm'n*, 162 Tex. 274, 346 S.W.2d 801 (1961). The courts will not "prescribe any rule or standard to guide the commission, except that its action must be legal, reasonable, and not arbitrary." *Brown v. Humble Oil & Ref. Co.*, 126 Tex. 296, 83 S.W.2d 935, *rehearing denied*, 87 S.W.2d 1069, 1070 (1935).

¹⁹ *Railroad Comm'n v. Magnolia Petroleum Co.*, 130 Tex. 484, 109 S.W.2d 967 (1937); *Brown v. Humble Oil & Ref. Co.*, *supra* note 18; Tex. Rev. Civ. Stat. Ann. art. 6049c, § 8 (1962).

ever, that it is its duty to conserve oil and gas above ground as well as below [T]he Commission must be fair, and must not indulge in unreasonable discriminations between different oil fields, or between different tracts of land in the same field. In determining the issue of fairness or discrimination, some latitude must be allowed, because the subject of administration is so vast, complex, and complicated that its administrative agency cannot be placed in an absolute strait jacket.²⁰

In reviewing a Commission action the courts will not investigate the *methods* adopted for conserving oil nor the motive or *purpose* which prompted them.²¹ They will not substitute their notions of expediency and fairness for those of the agency to which the formulation and execution of the conservation policy of the state have been entrusted.²² In most cases, judicial review is thus limited to determining whether a particular rule, regulation or order is within the delegated authority of the Commission, not whether the particular action is the proper *means* to accomplish its objective.²³ The issue is whether the rule, regulation or order is reasonably supported by "substantial evidence." Chief Justice Calvert stated the general rule in his dissent in *Coloma*:²⁴ "Art. 6049c, Sec. 8 . . . expressly provides that the order of the Commission 'shall be deemed prima facie valid' and that on appeal to the district court 'the burden of proof that the order is *not* supported by substantial evidence is upon the party complaining' of the order."²⁵ This likewise should hold true under the Pooling Act.

III. THE RULE 37 EXCEPTION

The unusual nature of prior treatment of the small tract problem arose by virtue of the basic spacing regulation in Texas, Rule 37, and its exceptions. Before the evolutionary development of the Pooling Act and the conceptual milieu preceding it can be fully appreciated, one must understand the nature and origin of this important spacing rule.

²⁰ *Gulf Land Co. v. Atlantic Ref. Co.*, 134 Tex. 59, 79, 131 S.W.2d 73, 85 (1939). As Mr. Justice Holmes said in *Bain Peanut Co. v. Pinson*, "We must remember that the machinery of government would not work if it were not allowed a little play in its joints." 282 U.S. 499, 500 (1931).

²¹ *Railroad Comm'n v. Galveston Chamber of Commerce*, 105 Tex. 101, 145 S.W. 573 (1912).

²² *Atlantic Ref. Co. v. Railroad Comm'n*, 162 Tex. 274, 346 S.W.2d 801 (1961); *Railroad Comm'n v. Rowan & Nichols Oil Co.*, 310 U.S. 573 (1940).

²³ And even then only if such rule, regulation, or order is not reasonably supported by "substantial evidence." See generally Harris, *A Reappraisal of the Substantial Evidence Rule in Texas Administrative Law*, 3 Sw. L.J. 416 (1949); Larson, *The Substantial Evidence Rule*, 5 Sw. L.J. 152 (1951); Walker, *The Application of the Substantial Evidence Rule in Appeals from Orders of the Railroad Commission*, 32 Texas L. Rev. 639 (1954).

²⁴ *Coloma Oil & Gas Corp. v. Railroad Comm'n*, 163 Tex. 483, 358 S.W.2d 566 (1962).

²⁵ *Id.* at 495, 358 S.W.2d at 569. It should be noted that the Chief Justice's dissent is a valid statement of the law absent the peculiarities of that fact situation.

A. History and Purpose

The constitutional power of an administrative body such as the Commission to make spacing rules has been sustained in the United States Supreme Court.²⁶ The first well-spacing rule in the United States was promulgated by the Commission in 1919, viz., Statewide Rule 37.²⁷ The objective²⁸ of the rule is the prevention of waste, *i.e.*, the conservation of resources, constituting thereby a modification of the basic Rule of Capture.²⁹

Subsection (A) (1) of Rule 37 now provides that no well shall be drilled less than 1200 feet from any other well on the same tract or farm nor less than 467 feet from any property line, lease line or subdivision line; thus, the general rule is one well per forty-acre tract.³⁰ However, subsection (D) reserves to the Commission the right to enter special orders altering these distances. This is the renowned "Rule 37 Exception" which allows well permits for tracts of less than forty acres. Its primary purpose is to protect correlative rights within a pool and to allow each mineral owner a fair chance to produce the oil and gas underlying his tract.³¹ "Every tract, however small, having a separate existence prior to the application of the rule [37] to the vicinity, is entitled to one well, as a matter of right"³² *if* essential for the avoidance of waste or prevention of confiscation. Because the right to an exception permit is predicated on preventing confiscation, the protection is afforded the owner and not the tract.³³

B. Voluntary Subdivision Rule

"[N]o subdivision of property made subsequent to the adoption

²⁶ The Court refused to review a holding that the power was constitutional in *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943). See also *Oxford Oil Co. v. Atlantic Oil & Producing Co.*, 16 F.2d 639 (N.D. Tex. 1926); *Railroad Comm'n v. Bass*, 10 S.W.2d 586 (Tex. Civ. App. 1928).

²⁷ Rule 37, and the granting of exceptions thereto, was held constitutional as a reasonable exercise of the police power in *Brown v. Humble Oil & Ref. Co.*, 126 Tex. 296, 83 S.W.2d 935 (1935) and cases cited therein.

²⁸ See discussion in *Myers, Pooling and Unitization* 11 (1957).

²⁹ *Trapp v. Shell Oil Co.*, 145 Tex. 323, 198 S.W.2d 424 (1946); *Brown v. Hitchcock*, 235 S.W.2d 478 (Tex. Civ. App. 1950) *error ref.*; *Nash v. Shell Petroleum Corp.*, 120 S.W.2d 522 (Tex. Civ. App. 1938) *error disp. w.o.j.*

³⁰ Rule 37(B), *Texas Railroad Comm'n Rules & Regs.*, § 1, at 16 (June, 1964). This minimum should continue under the Pooling Act, which basically sets *maximums* of 160 acres for oil units and 640 acres for gas units "plus 10% tolerance." Section 2(a).

³¹ The legislature can regulate for the protection of correlative rights even in absence of waste. *Ohio Oil Co. v. Indiana*, 177 U.S. 190 (1900); *Corzelius v. Harrell*, 143 Tex. 509, 186 S.W.2d 961 (1945).

³² *Myers, Common Ownership and Control in Spacing Cases*, 31 Texas L. Rev. 19 (1952).

³³ *Railroad Comm'n v. Williams*, 163 Tex. 370, 356 S.W.2d 131 (1962) (ownership of other producing properties in same pool protected plaintiff against confiscation—permit denied); *Coloma Oil & Gas Corp. v. Railroad Comm'n*, 163 Tex. 483, 358 S.W.2d 566 (1962) (the other producing properties need not be contiguous before permit is denied); *Shell Petroleum Corp. v. Railroad Comm'n*, 137 S.W.2d 797 (Tex. Civ. App. 1940) (drainage of plaintiff's land offset by drainage onto it—permit denied).

[for a particular field] of the original spacing rule will be considered in determining whether or not any property is being confiscated within the terms of such spacing rule³⁴ Thus, a Rule 37 exception permit may not be issued for a "voluntary subdivision." The date this rule attaches to a field is "the date of discovery of oil or gas production in a certain continuous reservoir regardless of the subsequent lateral extensions of such reservoir"³⁵ This restriction on the issuance of exception permits prevents circumvention and is essential to the preservation of Rule 37 itself.³⁶ It is often called the "rule of May 29th" (the date of its adoption in 1934) and has been held by the Supreme Court of Texas³⁷ to be a valid and enforceable amendment to Rule 37. A liberalization of this rule exists in the Rule of the Century Case,³⁸ whereby a tract "voluntarily subdivided" may be reconstructed and granted an exception permit if none of the subdivisions would otherwise be entitled to a well.³⁹

C. Compensation Through Allowables

The Commission is able to offset the initial advantage obtained by one who is given an exception to the well-spacing rule by limiting his production.⁴⁰ In this way the Commission can accomplish simultaneously its goals of both preventing waste and affording each owner the opportunity of fully developing and recovering his share of production. The utilization of allowables is the second great instrument of the Commission for conserving oil and gas and is a valid exercise of power for the prevention of waste and confiscation.⁴¹ In determining the total state allowable, the Commission relies to some extent on

³⁴ Rule 37(G)(1), Texas Railroad Comm'n Rules & Regs., § 1, at 16 (June, 1964). See also Meyers, *supra* note 32, at 19-20.

³⁵ Rule 37(G)(3), Texas Railroad Comm'n Rules & Regs., § 1, at 16 (June 1964).

³⁶ Gulf Land Co. v. Atlantic Ref. Co., 134 Tex. 59, 131 S.W.2d 73 (1939); Brown v. Hitchcock, 235 S.W.2d 478 (Tex. Civ. App. 1951) *error ref.*; Humble Oil & Ref. Co. v. Lasseter, 120 S.W.2d 541 (Tex. Civ. App. 1938) *error dism.*; Nash v. Shell Petroleum Corp., 120 S.W.2d 522 (Tex. Civ. App. 1938) *error dism. w.o.j.*

³⁷ Gulf Land Co. v. Atlantic Ref. Co., 134 Tex. 59, 131 S.W.2d 73 (1959). The court stated that the "more wells, more oil" theory, even if established as valid, does not justify an exception well, for such basis, if allowed, would nullify the rule. See also Trapp v. Shell Oil Co., 145 Tex. 323, 198 S.W.2d 424 (1946); Railroad Comm'n v. Shell Oil Co., 139 Tex. 66, 161 S.W.2d 1022 (1942).

³⁸ Railroad Comm'n v. Magnolia Petroleum Co., 130 Tex. 484, 109 S.W.2d 967 (1937).

³⁹ Inequities arise here since whoever gets the permit for the reconstructed-tract well on his land cannot be forced to share proceeds with other owners in the tract. Ryan Consol. Petroleum Corp. v. Pickens, 155 Tex. 221, 285 S.W.2d 201 (1955). See Meyers, *supra* note 32, at 20. With the advent of the compulsory pooling system this inequity is practically eliminated.

⁴⁰ Brown v. Humble Oil & Ref. Co., 126 Tex. 296, 313, 83 S.W.2d 935, 944 (1935); Delhi-Taylor Oil Corp. v. Gregg, 337 S.W.2d 216 (Tex. Civ. App. 1960); Stanolind Oil & Gas Co. v. Railroad Comm'n, 96 S.W.2d 664 (Tex. Civ. App. 1936).

⁴¹ Railroad Comm'n v. Rowan & Nichols Oil Co., 310 U.S. 573 (1940); Brown v. Humble Oil & Ref. Co., *supra* note 40; Kraker v. Railroad Comm'n, 188 S.W.2d 912 (Tex. Civ. App. 1945) *error ref.*

the monthly estimated demand for petroleum and its products published by the Bureau of Mines.⁴² The Commission also obtains nominations, which reveal the quantities of oil which purchasers anticipate buying during the subsequent month, at its monthly "statewide hearing."⁴³ The total state allowable, which must be divided among all the fields without unnecessary discrimination,⁴⁴ is announced at this hearing. Regardless of the demand, no well is permitted to produce in excess of its maximum efficient rate,⁴⁵ and any proration must be "among the various producers of a reasonable basis."⁴⁶

IV. FAIR SHARE AND THE RULE OF CAPTURE

If a Rule 37 exception permit is granted to drill a well on a tract smaller than that generally required under the spacing regulations and a producing well is completed, the allocation of allowables among producers from that reservoir can present a conflict between ownership in place and the law of capture. This basic conceptual conflict was an important underlying issue in *Normanna*⁴⁷ and its successors, developing the idea of "fair share," and is of continued importance under the Pooling Act.

The rule of capture "simply is that the owner of a tract of land acquires title to the oil or gas which he produces from wells on his land, though part of the oil or gas may have migrated from adjoining lands."⁴⁸ Probably the most famous of the early cases enunciating the rule was *Barnard v. Monogabela Natural Gas Company*,⁴⁹ which advised an adjacent landowner that his only remedy was to "go and do likewise."⁵⁰ In Texas there is even some legislative direction of uncompensated drainage in the Marginal Well Statute,⁵¹ but basically

⁴² See discussion in Myers, Pooling and Unitization 4, 9 (1957).

⁴³ See Greenhill & McGinnis, *Practice and Procedure in Oil and Gas Hearings in Texas*, 18 Sw. L.J. 406, 407-08 (1964).

⁴⁴ *Railroad Comm'n v. Continental Oil Co.*, 157 S.W.2d 695 (Tex. Civ. App. 1941) *error ref.*

⁴⁵ Meyers, *supra* note 32, at 20.

⁴⁶ Tex. Rev. Civ. Stat. Ann. art. 6049c, § 7 (1962).

⁴⁷ *Atlantic Ref. Co. v. Railroad Comm'n*, 162 Tex. 274, 346 S.W.2d 801 (1961), noted in 16 Sw. L.J. 320 (1962) (hereinafter referred to as *Normanna*).

⁴⁸ *Elliff v. Texon Drilling Co.*, 146 Tex. 575, 581, 210 S.W.2d 558, 561-62 (1948). See also *Ryan Consol. Petroleum Corp. v. Pickens*, 155 Tex. 221, 285 S.W.2d 281 (1956); *Brown v. Humble Oil & Ref. Co.*, 126 Tex. 296, 83 S.W.2d 935, (1935); *Stephens Co. v. Mid-Kansas Oil & Gas Co.*, 113 Tex. 160, 254 S.W. 290 (1923) (rule of capture in conjunction with ownership in place); *General Crude Oil Co. v. Harris*, 101 S.W.2d 1098 (Tex. Civ. App. 1937) *error dism.*

⁴⁹ 216 Pa. 362, 65 Atl. 801 (1907).

⁵⁰ *Id.* at 802. The first rule of capture case in the United States, however, was *Westmoreland & Cambria Natural Gas Co. v. DeWitt*, 130 Pa. 235, 18 Atl. 724 (1889). See also Myers, Pooling and Unitization 18 (1957) and Note, 17 Sw. L.J. 674 (1963).

⁵¹ Tex. Rev. Civ. Stat. Ann. art. 6049b, § 1 (1962) sets minimum allowables on particular wells according to their depths, regardless of any resultant waste or uncompensated drainage. See also *Railroad Comm'n v. Rowan & Nichols Oil Co.*, 310 U.S. 573 (1940); *Op. Att'y. Gen. (Tex.) 1845* (Jan. 17, 1940); Note, 24 Texas L. Rev. 519 (1946).

the rule of capture is subject to the conservation regulations enacted under the state police power.⁵²

A. *Atlantic*⁵³ And *Halbouty*⁵⁴

The concept of "fair share," emphasized in these two recent supreme court cases, which seeks to give each landowner the right to recover minerals underlying his tract, has been discussed at length in an article by Robert E. Hardwicke and M. K. Woodward, in which the rule was stated to be:

When a statute or regulation thereunder has the effect of permitting one owner to produce more than his fair share, thereby giving the opportunity of draining the excess from the land of others who are denied the opportunity to produce their fair shares, confiscation of property and denial of equal protection of the laws result, and the statute or regulation is invalid, unless the drainage takes place as an unavoidable result of reasonable regulation to prevent waste.⁵⁵

This concept had been foreshadowed in the lower courts of this state as early as 1936,⁵⁶ as well as in the later Texas Supreme Court cases of *Gulf Land Co. v. Atlantic Ref. Co.*⁵⁷ and *Marrs v. Railroad Comm'n.*⁵⁸ Its fundamental influence is manifest even in the Pooling Act.

In *Normanna* (a Rule 37 exception case with a generous small-tract allowable) the court declared invalid a 1/3-2/3 gas allocation order⁵⁹ which would have allowed a .3 acre tract to produce over 200 times as much gas per acre as a well on a 320 acre unit. Even though the original value of gas in place under the small tract was only \$7000, gas valued at some \$2,500,000 would have been produced by the well on the .3 acre tract during the estimated life of the field.

⁵² *Corzelius v. Harrell*, 143 Tex. 509, 186 S.W.2d 961 (1945).

⁵³ *Atlantic Ref. Co. v. Railroad Comm'n.*, 162 Tex. 274, 346 S.W.2d 801 (1961), noted in 16 Sw. L.J. 320 (1962).

⁵⁴ *Halbouty v. Railroad Comm'n.*, 163 Tex. 417, 357 S.W.2d 364 (1962), *cert. denied sub nom. Dillon v. Halbouty*, 371 U.S. 888 (1962), noted in 17 Sw. L.J. 674 (1963) (also referred to herein as *Port Acres*).

⁵⁵ Hardwicke & Woodward, *Fair Share and the Small Tract in Texas*, 41 Texas L. Rev. 75, 83 (1962).

⁵⁶ "The right of each individual leaseholder extends no further than the opportunity to extract his *fair share* of the oil, measured by a reasonable approximation of the amount of oil *in place* under his leasehold." *Magnolia Petroleum Co. v. Railroad Comm'n.*, 93 S.W.2d 587, 588 (Tex. Civ. App. 1936) *error ref.* (Emphasis added.)

⁵⁷ 134 Tex. 59, 131 S.W.2d 73 (1939). "It is the law that every owner or lessee of land is entitled to a fair chance to recover the oil and gas in or under his land, or their equivalents in kind. Any denial of such fair chance would be 'confiscation' within the meaning of Rule 37 and the Rule of May 29th." *Id.* at 71, 131 S.W.2d at 80. See also *Empire Gas & Fuel Co. v. Railroad Comm'n.*, 94 S.W.2d 1240 (Tex. Civ. App. 1936) *error ref.*

⁵⁸ 142 Tex. 293, 177 S.W.2d 941 (1944).

⁵⁹ That is, one-third of the pool allowable divided *equally* among the wells and two-thirds in the proportion that the individual well bears to the total field acreage.

The Commission's response was the Normanna Fields Special Order No. 2-46673,⁶⁰ which set the basic allowable for the entire field on a 100 per cent surface acreage basis. However, any owner of a tract of less than 100 acres, entitled to a Rule 37 exception permit, can obtain a special allowable upon proof that such allowable is economically necessary *and* that all adjoining tract-owners have "refused to allow the pooling of said tract with enough of said immediately adjacent acreage to create a drilling unit of at least 100 acres upon fair and reasonable terms . . ."⁶¹ This latter prerequisite, a "reasonable offer to voluntarily pool," is codified in the Pooling Act.⁶² The provision is rather unique among compulsory pooling statutes, a fact which further evidences the important influence of the case law upon this statute. It is apparent that such arbitrary formulas as that in *Normanna* will not be upheld by the supreme court, at least with respect to newly-discovered reservoirs,⁶³ because they are not reasonably calculated to adequately protect correlative rights. The protection of correlative rights, being a jurisdictional limitation on the Commission's powers, necessarily qualifies that agency's authority under the Pooling Act as well. Since the Commission's duties regarding *allowables* remain unchanged by the Pooling Act, Texas courts will continue to be called upon to determine the propriety of allocation formulas between units.⁶⁴ Moreover, even within a compulsory unit the Commission must determine participation percentages, and the courts will be importuned, therefore, to consider such determinations—a situation highly analogous to *Normanna* and its successors.

B. *Limitations On Fair Share*

Inherent in the rule of fair share were two exceptions, with implications of a third. The *Normanna* case itself instituted the first—the precedence of the demands of conservation and the prevention of waste. It was noted there that the Commission is responsible for devising a proration rule which will *conserve* the gas in the field and be fair and just to all parties.⁶⁵

⁶⁰ Texas Railroad Comm'n Rules & Regs., § 7, at 917, 14 O. & G.R. 885 (1961).

⁶¹ *Id.* at 918 (Nov. 1961). Similar disparities existed in the *Port Acres* situation with similar results. In that case each one-acre lot relied on drainage for 92.87% of its condensate recovery. Wells having .65% of the total surface acreage received 14.6% of the allowable, and small tracts with 1.77% of the producing sand would have recovered 20.46% of the gas and condensate of the field. *Special Order No. 3-51035* (March 1, 1963) resulted. Commissioner Jim C. Langdon discusses this order in *The Influence of Court Decisions upon Railroad Commission Policy in Rule 37 Cases and the Allocation of Allowables to the Small Tract Well*, 22 Oil and Gas Compact Bulletin 100 (1963).

⁶² Section 2(a).

⁶³ See notes 104 and 105 *infra* and accompanying text.

⁶⁴ Disputes will, of course, be much less frequent without the large tract—exception tract dichotomy.

⁶⁵ *Henderson v. Railroad Comm'n*, 56 F.2d 218 (W.D. Tex. 1932). See also note 57 *supra*.

The second exception, declared by the court in the *Marrs* case,⁶⁶ is that the order must not require *unnecessary expense* in obtaining the fair share. In that case the court ruled that Gulf Oil did *not* have to drill additional wells to increase its total allowable sufficiently for recovery of its fair share because present wells were adequate with an increased allowable. The underlying rationale was that the requirement of such unnecessary expense is in itself no less a confiscation than declaring an *insufficient* allowable.

These two limitations on fair share were important motivating factors behind passage of the Pooling Act, which in effect harmonizes these previously antithetical demands and provides each owner with more nearly his fair share, with minimal waste, and without unnecessary expense. *Normanna* also implies the third limitation, concerning timely complaint, which will be hereinafter considered.⁶⁷

C. *The Status Of Rule Of Capture*

Fundamentally, there are two alternative theories of ownership: either rule of capture modified to protect correlative rights, or ownership in place modified to prevent waste. Although the court in *Halbouty* seemed to lean in the direction of the latter, recent cases⁶⁸ indicate a recognition of the administrative difficulties involved under that interpretation⁶⁹ and somewhat of a withdrawal therefrom. The Texas Supreme Court, while having enunciated both theories, has generally adhered to the rule of capture as the less complicated, more workable solution.⁷⁰ "The property right is not in oil and gas as such; it is the right to a 'fair chance' or 'reasonable opportunity' to produce or receive oil and gas in his land or the equivalent amount."⁷¹ Indeed, Justice Greenhill, in the most recent supreme court decision in this area,⁷² pointed out that in a Rule 37 exception permit case the landowner is entitled only to a fair chance to recover the oil and gas in and under his tract. "But in determining the validity of a field-wide proration order, the landowner is not wholly restricted to a recovery of reserves underlying his tract. The test . . . is whether he has an opportunity to produce his fair share of the minerals in

⁶⁶ *Marrs v. Railroad Comm'n*, 142 Tex. 293, 177 S.W.2d 941 (1944).

⁶⁷ See notes 111-123 *infra* and accompanying text.

⁶⁸ *Railroad Comm'n v. Aluminum Co. of America*, 380 S.W.2d 599 (Tex. 1964); *Railroad Comm'n v. Shell Oil Co.*, 380 S.W.2d 556 (Tex. 1964).

⁶⁹ See note 21 *supra* and accompanying text. See also Kuntz, *The Law of Capture*, 10 Okla. L. Rev. 406 (1957); Note, 17 Sw. L.J. 674, 677 (1962).

⁷⁰ *Japhet v. McRae*, 276 S.W. 669 (Tex. Comm. App. 1925); *Ryan Consol. Petroleum Corp. v. Pickens*, 155 Tex. 221, 285 S.W.2d 210 (1956).

⁷¹ *Magnolia Petroleum Co. v. Railroad Comm'n*, 93 S.W.2d 587, 588 (Tex. Civ. App. 1936) *error ref.* See also Hardwicke & Woodward, *Fair Share and the Small Tract in Texas*, 41 Texas L. Rev. 75, 94 (1962).

⁷² *Pickens v. Railroad Comm'n*, 387 S.W.2d 35 (Tex. 1965) (*Fairway Field* case).

the reservoir."⁷³ The *Halbouty* case has been analyzed to the same effect.⁷⁴ Although art. 6008⁷⁵ modifies the rule of capture, with respect to allowables, to protect correlative rights to the extent practical, that rule remains the law in cases in which no allowables have been established and no adjacent owners have drilled wells. *Halbouty* "should be taken merely as demonstrating reasonable police power modification of the rule of capture, not a new rule of property based on ownership in place."⁷⁶

V. SHELL⁷⁷ AND ALCOA⁷⁸ CASES

Further refinements of *Normanna* and *Port Acres* crystalized when the Texas Supreme Court handed down its decisions in *Shell* and *Alcoa* on May 27, 1964. The *Shell* case⁷⁹ concerned an oil proration order based on a fifty per cent per well and fifty per cent acreage formula, issued by the Commission on June 27, 1962, after extensive hearings. Motion for rehearing was timely filed with the Commission on July 11 and overruled on July 18. Shell filed suit in the state district court in Travis County, Texas, on August 8 to contest the order.⁸⁰

The *Alcoa* case⁸¹ was an attack on a Commission order which had been adopted for the entire Appling Field, by temporary order, on January 30, 1961.⁸² The field was a complicated multi-reservoir field yielding primarily gas in thirty-eight separately-prorated gas reservoirs, due to "various zones which [were] separated vertically [and which were] broken into separate fault blocks or segments."⁸³ All prior orders, regarding reservoirs discovered earlier (dating back to 1956), and orders concerning fields not previously having special field rules were synthesized into this single order, which recited that

⁷³ *Id.* at 42.

⁷⁴ Discussion note, 16 O. & G.R. 813 (1962).

⁷⁵ Tex. Rev. Civ. Stat. Ann. art. 6008 (1962).

⁷⁶ Discussion note, 16 O. & G.R. 813 (1962).

⁷⁷ Railroad Comm'n v. Shell Oil Co., 380 S.W.2d 556 (Tex. 1964).

⁷⁸ Railroad Comm'n v. Aluminum Co. of America, 380 S.W.2d 599 (Tex. 1964).

⁷⁹ Railroad Comm'n v. Shell Oil Co., 380 S.W.2d 556 (Tex. 1964).

⁸⁰ An action to cancel a Commission order pursuant to Tex. Rev. Civ. Stat. Ann. art. 6049c, § 8 (1962) exists only by statute and not by virtue of the Constitution or the common law. *Burford v. Sun Oil Co.*, 186 S.W.2d 306 (Tex. Civ. App. 1944) *error ref.* See also *Alpha Petroleum Co. v. Terrell*, 122 Tex. 257, 59 S.W.2d 364 (1933).

⁸¹ Railroad Comm'n v. Aluminum Co. of America, 380 S.W.2d 599 (Tex. 1964).

⁸² After the formal conference between the examiner and the Commissioners, the former sends to all parties in interest a letter which constitutes the temporary order of the Commission. The date of this order becomes the *effective* date of the formal Commission order issued later. See Greenhill & McGinnis, *Practice and Procedure in Oil and Gas Hearings in Texas*, 18 Sw. L.J. 406, 431 (1964). The formal order of April 24, 1961, in *Alcoa* was made effective as of January 20, 1961, by the letter order.

⁸³ Railroad Comm'n v. Aluminum Co. of America, 368 S.W.2d 818, 821 (Tex. Civ. App. 1963).

all former orders were rescinded. The substance of these prior orders, however, remained unchanged, thus maintaining the consistent one-third per well—two-thirds acreage formula for gas throughout, since the aggregation was merely for the sake of clarity and convenience of administration. No rehearing was sought; however, Alcoa brought suit in the district court attacking the order as a whole on April 3.⁸⁴

In both *Alcoa* and *Shell* the district court found the orders arbitrary, unreasonable, capricious and confiscatory because not supported by substantial evidence, and set them aside. The Court of Civil Appeals affirmed both decisions.⁸⁵ It is worthy of note that *Shell* was the first case to apply the *Normanna* fair share rule to an order prorating oil production. As might have been anticipated, the supreme court gave the fifty-fifty oil formula identical treatment to that afforded gas under the one-third—two-thirds formula. Likewise noteworthy was a statement indicating that, contrary to wishful speculation by large tract owners, adoption of a 100 per cent acreage factor is not intended to be the sole alternative. "[T]he issue here drawn is not whether the 50-50 or 100 per cent acreage formula be adopted."⁸⁶ Thus, other less arbitrary formulas *short* of the latter criterion are not precluded,⁸⁷ a factor of continued direct and indirect importance under the Pooling Act.

VI. ACQUIESCENCE AND UNREASONABLE DELAY

Although greatly clarified under the Pooling Act,⁸⁸ the problem of timeliness for appeals from Railroad Commission orders was of major, recent concern under the case law. The indefinite standard previously employed had the advantages of flexibility and capacity to do equity under varying circumstances, but it provided no predictable guide by which to act. The Pooling Act provision is indeed an innovation in Texas administrative procedure; however, the recent decisions under the old system are an integral part of a unique Texas contribution to oil and gas law—the Rule 37 exception. Moreover, even though case law in the area of timely appeal is of limited direct applicability under the Pooling Act, many phases of

⁸⁴ See Griffin, *Mineral Law: Recent Cases of Interest to the Bar*, 27 Texas B.J. 781, 816-20 (1964).

⁸⁵ *Railroad Comm'n v. Aluminum Co. of America*, 368 S.W.2d 818 (Tex. Civ. App. 1963); *Railroad Comm'n v. Shell Oil Co.*, 369 S.W.2d 363 (Tex. Civ. App. 1963).

⁸⁶ *Railroad Comm'n v. Shell Oil Co.*, 380 S.W.2d 556, 560 (Tex. 1964).

⁸⁷ Neither must the formula be based 100% on net acre-feet. "While the Court [in *Halbouty*] struck down the particular formula with the large 'per well' factor in it, the Court did not direct or even hint that a 100 percent acre-foot formula would be the only acceptable one." *Pickens v. Railroad Comm'n*, 387 S.W.2d 35, 44 (Tex. 1965) (upholding a 50% surface acreage-50% acre-foot formula).

⁸⁸ Section 2 (g) provides for a 30-day appeal period from orders within its scope.

it will still be applied by analogy, both in interpretation of the Pooling Act and in other administrative contexts.

The first indication by the Texas Supreme Court that an unreasonable delay in contesting Commission orders might bar appeal by the contesting party was in *Gulf Land Co. v. Atlantic Ref. Co.*,⁸⁹ in which the Court said:

It will be noted that section 8 of article 6049c . . . provides no time within which suit to test the validity of the rules, regulations, and orders of the Commission shall be filed The very nature of the appeal thus provided would make it very difficult for the Legislature to frame a just statute to apply in all instances. We think, however, that unreasonable delay in appealing orders pertaining to well permits which cause the opposite party to act, to his injury, might give rise to a question of estoppel.⁹⁰

The statute referred to demands only that such suits "be determined as expeditiously as possible and no postponement thereof or continuance shall be granted except for reasons deemed imperative by the Court."⁹¹ In *Normanna* the court indicated that one reason for its denial of writ of error (with the notation "n. r. e.") in the *Hawkins Field*⁹² and *Yates Field*⁹³ cases was that the large tract owners had acquiesced in long-established Commission rules for the fields in question, and *other* owners had expended large sums of money in reliance upon those rules. It thereupon concluded, in an important dictum, that "where producers have acquiesced in and have failed to complain of the Commission's proration orders for a long period, during which time other operators have expended vast sums in exploration and drilling operations, such producers should not be heard to complain."⁹⁴

Realizing this statement to be dictum, the court noted in *Alcoa* that "nevertheless it was said deliberately, to put the Commission and the industry as a whole on notice"⁹⁵ of the probable status of the law.⁹⁶ The court emphasized the extreme need for *stability* of

⁸⁹ 134 Tex. 59, 131 S.W.2d 73 (1939).

⁹⁰ *Id.* at 85-86. See also *Railroad Comm'n v. Mackhank Petroleum Co.*, 144 Tex. 393, 190 S.W.2d 802 (1945); *Midas Oil Co. v. Stanolind Oil & Gas Co.*, 142 Tex. 417, 179 S.W.2d 243 (1944); *Pan American Petroleum Corp. v. Railroad Comm'n*, 335 S.W.2d 425 (Tex. Civ. App. 1960) *error ref. n.r.e.*; *Dunbar v. Fuller*, 253 S.W.2d 684 (Tex. Civ. App. 1952) *error ref.*

⁹¹ Tex. Rev. Civ. Stat. Ann. art. 6049c, § 8 (1962).

⁹² *Railroad Comm'n v. Humble Oil & Ref. Co.*, 193 S.W.2d 824 (Tex. Civ. App. 1946) *error ref. n.r.e.*

⁹³ *Standard Oil Co. v. Railroad Comm'n*, 215 S.W.2d 633 (Tex. Civ. App. 1948) *error ref. n.r.e.*

⁹⁴ *Atlantic Ref. Co. v. Railroad Comm'n*, 162 Tex. 274, 288, 346 S.W.2d 801, 811 (1961).

⁹⁵ *Railroad Comm'n v. Aluminum Co. of America*, 380 S.W.2d 599, 601 (Tex. 1964).

⁹⁶ See text accompanying notes 105 and 106 *infra*.

Commission orders concerning the oil and gas industry.⁹⁷ A great deal of confusion and serious injustice would accompany a rescission of these established formulas and an impossible burden would be placed on the Commission in determining and administering new allowables. "It is of vast importance to the industry, as well as to the property owners in the field and the Commission as the representative of the public generally, that proration formulae be as stable as reasonably possible"⁹⁸

By the same token, a permittee should have the assurance of relying on stable orders. He should not be forced to choose between drilling, with the possibility of losing his investment due to a later unfavorable alteration in allowables, and waiting indefinitely for the contestant to bring suit, with the inevitable continuing loss of reserves through drainage. Drilling is expensive, as is drainage; moreover, the probable beneficiary of this drainage is the prospective complainant himself, who therefore has cause to delay. There are, in short, very practical economic reasons demanding prompt attack of orders regulating the production of oil and gas. The legislature's establishment of a short appeal period under the Pooling Act evidences its recognition of this need.

In *Shell*⁹⁹ the Commission and the small tract owners contended that (1) acquiescence in Rule 37 exception permits for the tracts in question estopped Shell from attacking proration orders thereon and (2) separate reservoirs in the same general area should be treated as one for purposes of determining unreasonable delay, so that prior acquiescence by Shell in allocations for *other* fields would estop it in an attack upon the present order. The supreme court rejected these contentions, however, and held that Shell did not unreasonably delay in contesting the Commission order.¹⁰⁰ First, there is no relationship between an exception permit and a proration order for any small tract which would bar a party from attacking one for failure to attack the other, as one order might easily be objectionable without the other.¹⁰¹ Moreover, it is now clear that physically separate reservoirs underlying the same tract are to

⁹⁷ Many individuals and institutions have invested in royalties and other oil and gas interests. Banks, insurance companies, and other lending agencies have made loans secured by oil and gas properties and the production therefrom. Municipal and school authorities often depend on taxes from these properties, which to a large extent affect the entire state economy.

⁹⁸ *Standard Oil Co. v. Railroad Comm'n*, 215 S.W.2d 633, 638 (Tex. Civ. App. 1948) *error ref. n.r.e.*

⁹⁹ *Railroad Comm'n v. Shell Oil Co.*, 380 S.W.2d 556 (Tex. 1964).

¹⁰⁰ *Ibid.*

¹⁰¹ *Benz-Stoddard v. Aluminum Co. of America*, 368 S.W.2d 94 (Tex. 1963).

be treated separately.¹⁰² Thus, the time for judicial attack must run from the date of adoption of original special field orders for the *particular reservoir in question* and not merely those underlying identical tracts. This will, of course, remain true under the Pooling Act. Because the court viewed Shell's prosecution of its complaint as being within a reasonable time after that effective date, it rejected the Commission's contention of unreasonable delay, laches and estoppel.¹⁰³

In the *Alcoa* case,¹⁰⁴ Alcoa contended that the order issued on January 20, 1961, was actually a new regulation with respect to *all* reservoirs because it expressly rescinded all prior orders and therefore was subject to attack in its entirety, notwithstanding acquiescence by complainant in any of the old orders. Instead, the court looked through the form of the revised order and held that in substance, as there were no "changed conditions"¹⁰⁵ and as the prior orders were unmodified, the petitioners were appealing from orders dating from as far back as 1956. It then alluded to the dictum in *Normanna*¹⁰⁶ and concluded that "the holding therein did not require the overturning of proration formulas that had been in effect . . . for years where operators had drilled and completed wells at great expense in reliance on those formulas and where conditions had become stabilized."¹⁰⁷ The court thus found that Alcoa's complaint had not been made within a reasonable time and, notwithstanding an estimated value of drainage from Alcoa's property during the life of the field in excess of nine million dollars, that it could not overturn the administrative action of the Commission in denying modifications of the allowable.¹⁰⁸

It can be seen, therefore, that the individual right to one's "fair share" is overridden by the pervasive necessity of stability and certainty in the regulation of oil and gas production. The obvious effect of this determination is to perpetuate the inequity established by the Commission in all "old pools," an unobjectionable result, however, in

¹⁰² *Ibid.*

¹⁰³ *Railroad Comm'n v. Shell Oil Co.*, 380 S.W.2d at 558.

¹⁰⁴ *Railroad Comm'n v. Aluminum Co. of America*, 380 S.W.2d 599 (Tex. 1964).

¹⁰⁵ The Commission has continuing power to change or modify prior orders where conditions have changed materially, new and unforeseen problems have arisen, or mistakes have been discovered. Tex. Rev. Civ. Stat. Ann. art. 6036a (1962); *Magnolia Petroleum Co. v. New Process Prod. Co.*, 129 Tex. 617, 104 S.W.2d 1106 (1937); *Railroad Comm'n v. Shell Oil Co.*, 369 S.W.2d 363 (Tex. Civ. App. 1963); *Railroad Comm'n v. Humble Oil & Ref. Co.*, 193 S.W.2d 824 (Tex. Civ. App. 1946) *error ref. n.re.*

¹⁰⁶ See note 94 *supra* and accompanying text.

¹⁰⁷ *Railroad Comm'n v. Aluminum Co. of America*, 380 S.W.2d 599, 601 (1964).

¹⁰⁸ The average per acre allowable of the small tracts involved was fifty-five times as large as the average for large tracts, and in all but one reservoir some eighty per cent of the town lot production was a direct result of drainage from beneath the large tracts.

view of the economic and administrative practicalities involved.¹⁰⁹ An uncertainty in this regard still exists in connection with wells drilled after a suit attacking the proration order has been instituted. Must the large tract operator attack the order itself or may he also attack the application of the order which ultimately causes the confiscation? This condition existed in *Alcoa*, but the question was not properly before the court. The court, however, did enunciate a caveat to owners of undrilled small tracts in "old" pools by expressly reserving its opinion on the issue. It stated, "We are dealing here with a field-wide rule. *Whether or not* there is any authority vested in the Commission to apply *exceptions* to a field-wide rule in some cases, that relief is not here sought by *Alcoa*. They seek to strike down the order as applicable to the *entire* field."¹¹⁰ In any event, the crucial inquiry becomes, when is a pool "old"—*i.e.*, what is an *unreasonable* delay in attacking the allocation?¹¹¹

Earlier cases have dealt with the timeliness of appeals from various Commission orders. The *Emperor Field* case¹¹² held delay to be unreasonable when 1956 proration orders were attacked in 1959 after forty-six wells had been drilled, pipelines had been laid and the producing area enlarged. This is an easy case by the court's present standards, but it emphasizes the point that, except under the Pooling Act, subsequent reliance on the Commission's orders may be important.¹¹³ On the other hand, notice to the permittee of an intention to

¹⁰⁹ There is, of course, a vital need for certainty and stability in oil and gas law. Moreover, as in *Halbouty*, the large tract owners might have an advantage toward recovering 100% of the original oil in place in the old pools through drilling prior to issuance of the Rule 37 exception permit.

¹¹⁰ *Railroad Comm'n v. Aluminum Co. of America*, 380 S.W.2d 599, 603 (Tex. 1964). (Emphasis added.) Nevertheless, the court emphasized the factor of foreseeability by pointing out that *Alcoa* must have appreciated the probability of future small tract drilling and drainage at the time the order setting an allowable was issued. This would indicate that large tract operators must anticipate any reasonably foreseeable drainage under the order and object at that time, even though no small tract drilling operations are then in progress.

¹¹¹ As a result some pools remain impervious to attack, and presumably any undrilled small tract (or reconstructed voluntary subdivision) in such pools could be drilled under the existing formula without being amenable to attack.

¹¹² *Pan American Petroleum Corp. v. Railroad Comm'n*, 335 S.W.2d 425 (Tex. Civ. App. 1960) *error ref. n.r.e.*

¹¹³ A delay of almost seven months in prosecuting a suit to set aside an order of the Board of Water Engineers also was held unreasonable as a matter of law in *Board of Water Engineers v. Colorado River Municipal Water Dist.* 152 Tex. 77, 254 S.W.2d 369 (1953). This case was cited as directly applying in *Alcoa* because the language in the controlling statute for appeals of Water Board orders, Tex. Rev. Civ. Stat. Ann. art. 7880-3c, § F (1954), is identical to that governing appeals from exception and proration orders of the Commission, Tex. Rev. Civ. Stat. Ann. art. 6049c, § 8 (1962). *Midas Oil Co. v. Stanolind Oil & Gas Co.*, 142 Tex. 417, 179 S.W.2d 243 (1944), also was cited; but, although appeal in *Midas* after only four months was held not timely, the court in *Alcoa* mentioned only the seven-month holding. Apparently this was the result of its recognition that permit cases (*e.g.*, *Midas*) are not of *direct* precedential value in allowable cases because the former are quasi-judicial in nature and involve vested rights whereas the latter

contest given four days after issuance of the Commission's order has been held not to be unreasonable delay, even though suit was not filed for almost three months and defendant was not served for two years.¹¹⁴

The companion cases presently under discussion¹¹⁵ more than ever exemplify the vital importance of a timely complaint to avoid denial of remedy. One may observe that the gap between the judicially-determined timely and untimely is narrow indeed, for the difference between the "reasonable" delay in *Shell* and the "unreasonable" delay in *Alcoa may* be as little as twenty-one days, exactly three weeks.¹¹⁶ The qualification "may" is used because all surrounding factors must be considered by the court, and it is often difficult or impossible to determine which factual elements are crucial. In the *Alcoa* case, the supreme court made no specific comment on the reservoirs with respect to which the "extension" order of January 20, 1961, was *original*—i.e., those to which no special field orders had previously attached. Alcoa noted in its brief in the supreme court that twenty-one of the thirty-eight separate gas reservoirs included in the order of January 30 had not theretofore been placed under special allocation rules.¹¹⁷ This point was urged more emphatically by Alcoa on its motion for rehearing. The attorney general, as counsel for the Railroad Commission, replied that, with the exception of one reservoir,¹¹⁸ there was no specific or definite evidence of any *substantial damage* resulting from the operation of the existing allocation formulas in these "new" pools.¹¹⁹ The court did not resolve this question, merely holding that the appeal as a whole was not timely

are quasi-legislative in nature, do not involve vested rights and are subject to continuous supervision of the Commission. *Railroad Comm'n v. Rowan & Nichols Oil Co.*, 310 U.S. 573 (1940); *Chenoweth v. Railroad Comm'n*, 184 S.W.2d 711 (Tex. Civ. App. 1944) *error ref.* The court nevertheless held permit cases to be pertinent. *Railroad Comm'n v. Aluminum Co. of America*, 380 S.W.2d 599, 602 (Tex. 1964).

¹¹⁴ *Humble Oil & Ref. Co. v. Trapp*, 194 S.W.2d 781 (Tex. Civ. App. 1946) *error ref.*

¹¹⁵ *Railroad Comm'n v. Aluminum Co. of America*, 380 S.W.2d 599 (Tex. 1964); *Railroad Comm'n v. Shell Oil Co.*, 380 S.W.2d 556 (Tex. 1964).

¹¹⁶ Six weeks in *Shell* and nine weeks in *Alcoa*. See text accompanying notes 79-82 *supra*. However, the effective holding could very well be six weeks (three in *Shell* and nine in *Alcoa*). See note 122 *infra*. Even if this is the case, there is only a 30-day span between *Alcoa* and *Pickens v. Railroad Comm'n*, 387 S.W.2d 35 (Tex. 1965) (33 days).

¹¹⁷ Respondents' Brief, p. 9, *Railroad Comm'n v. Aluminum Co. of America*, 380 S.W.2d 599 (Tex. 1964).

¹¹⁸ Fault Segment 9, Lower 7600' Sand—effective date of proration order November 1, 1960. Respondents' Brief, p. 9, *Railroad Comm'n v. Aluminum Co. of America*, 380 S.W.2d 599 (Tex. 1964).

¹¹⁹ Concerning these pools, one of Alcoa's expert witnesses had testified: "While wells in the Palo Alto townsite area at one time produced large quantities of gas, virtually all of these wells have gone to water and hence only the Carancahua Beach townsite, lying in Fault Segments 5 and 6, and the .81 acre tract lying in Fault Segment 2, are of importance in this case."

brought.¹²⁰ In short, the effective holding appears to be that nine weeks' delay in bringing suit is unreasonable, particularly if drilling operations are being prosecuted in reliance on the order under attack.¹²¹

An enigma in the *Shell* case lies in the effect of a motion for rehearing before the Commission—*i.e.*, does it extend the time for filing suit in the state district court? Although the Pooling Act does provide for appeals from its orders within thirty days, no mention is made of the effect of filing a motion for rehearing nor even of the time from which the thirty-day period is to run.¹²² Thus, while making some headway, the legislature has not completed its task of clarification regarding appeals. The usual rule of administrative law is that one must exhaust all administrative remedies before he may maintain an action in a court of law.¹²³ Presumably, then, fairness would dictate that one who is evidently *required* to expend part of the short appeal period pursuing the administrative remedy of rehearing should not be penalized thereby, and that his time would be extended to that degree. However, Mr. Justice Greenhill and Robert C. McGinnis observed in their recent article on Railroad Commission oil and gas hearings that "It has been held that the filing of a motion for rehearing is not a prerequisite to commencing a suit to test the validity of a Commission order; the administrative remedy is considered to be exhausted without filing a motion for rehearing."¹²⁴ Moreover, the effective date of a Commission order in most instances is unaltered by the filing of a motion for rehearing.¹²⁵ Together, these two factors argue against any extension of time by

¹²⁰ It is submitted that in light of *Halbouty v. Railroad Comm'n*, 163 Tex. 417, 357 S.W.2d 364 (1962), in which the court held that the large tract owners' recovery of 100% of their original reserves by virtue of early drilling was no defense, lack of *substantial* reserves likewise should be no defense. Indeed, of the *remaining* potential production, there still will be proportionately the same pro-rata injury to Alcoa. Moreover, by deciding on the basis of unreasonable delay, the court never reached the question of injury.

¹²¹ The effective holding otherwise would be that 22 weeks' delay was unreasonable. See date in note 118 *supra* and accompanying text.

¹²² Presumably the period will continue to run from the date of issuance of a "temporary order," as was true under the case law.

¹²³ "The doctrine of exhaustion of administrative remedies . . . is well established [and] is a cardinal principle of practically universal application." 2 Am. Jur. 2d § 595 (1963). For voluminous citations see *Ibid.*

¹²⁴ Greenhill & McGinnis, *Practice and Procedure in Oil and Gas Hearings in Texas*, 18 Sw. L.J. 406, 434-35 (1964). See also *Trapp v. Atlantic Ref. Co.*, 170 S.W.2d 506, 510 (Tex. Civ. App. 1943) *error ref.*; *Railroad Comm'n v. Houston Chamber of Commerce*, 124 Tex. 375, 78 S.W.2d 591, 595 (1935).

¹²⁵ "In oil and gas hearings other than Rule 37 [exception permit] matters, the filing of a motion for rehearing does not suspend the order automatically until the motion has been disposed of. The Commission usually grants a rehearing without suspending the effectiveness of its original order until the rehearing is held." Greenhill & McGinnis, *supra* note 124, at 434.

such action, although no definite conclusion can be drawn at this time.

If one assumes, however, that the filing of a motion for rehearing does not extend the time for judicial appeal, the result in *Sbell* was that a delay of forty-two days was not unreasonable.¹²⁶ Although the Court may not wish to so restrict itself, a workable criterion appears possible approaching the same result. In appealing from a state district court judgment, notice of appeal must be filed within ten days,¹²⁷ an appeal bond within thirty days,¹²⁸ and a statement of facts within fifty days.¹²⁹ Because no record of the Commission hearing need be filed, the time for initiating the suit attacking an allocation formula probably should fall within this fifty-day period. It is submitted that a reliable standard would be a maximum of forty days from date of issuance of the temporary letter order. This period might be extended in a particular case if, at the end of that time, no one had undertaken drilling operations in reliance on the order. On the other hand, if any small tract owner were proceeding with drilling operations by that time, thereby incurring substantial liability, any further delay in appeal would be imprudent. As a corollary, a small tract owner should not be able to impose upon the complainant any more stringent requirements by immediate drilling *within* this period. The owner would not be "justified" in relying on the order immediately, without allowing a reasonable time for complaint. Likewise, any wells drilled prior to issuance of the allocation order should not have the effect of reducing the reasonable time period. The *Halbouty*¹³⁰ case tends to support this conclusion. In that instance, production was obtained on the small tracts prior to issuance of the proration order, apparently under the assumption that the Commission would "extend" the prevailing one-third—two-thirds formula to include their reservoir, as it had done prior to the *Normanna* decision. This substantial premature expenditure apparently did not reduce the time period, which amounted to a timely thirty-nine days. It should be noted, however, that any drilling in anticipation of the Commission's field order for a particular reservoir is now highly improbable, in light of *Normanna*.

In contrast to the variable standard of reasonableness applying

¹²⁶ On the other hand, if the rehearing period does extend the appeal time, the effective holding is that 21 days after final disposition of the motion for rehearing is soon enough. It has subsequently been held, however, that delay of 33 days was not unreasonable. *Pickens v. Railroad Comm'n*, 387 S.W.2d 35 (Tex. 1965).

¹²⁷ Tex. R. Civ. P. 353.

¹²⁸ Tex. R. Civ. P. 356.

¹²⁹ Tex. R. Civ. P. 381.

¹³⁰ *Halbouty v. Railroad Comm'n*, 163 Tex. 417, 357 S.W.2d 364 (1962).

to appeals from other Commission orders, the Pooling Act establishes an absolute limit of thirty days. Although the event from which this period runs is not specified, the time requirement is tied to the order itself and therefore should not be influenced by the presence or absence of drilling in reliance on that order. In this respect the Pooling Act establishes a definite standard, but at the expense of flexibility and, in many cases, equity.

VII. REVOCATION AND AMENDMENT OF FIELD ORDERS

The Texas statutes¹³¹ supply the *courts'* jurisdiction to consider the validity of orders of the Railroad Commission.¹³² This authority is limited, however, by the substantial evidence rule and extends only to the issue of validity. The court may not substitute its judgment for that of the Commission regarding the *nature* of the appropriate new order. Furthermore, it now should be clear that the courts do not act under certain circumstances giving rise to the defense of laches, estoppel or unreasonable delay. Neither may they act after thirty days under the Pooling Act.¹³³ Notwithstanding these judicial limitations, the *Commission* has continuing jurisdiction over its field orders,¹³⁴ except under the Pooling Act. It may revoke or amend any rule, regulation or order previously promulgated;¹³⁵ the effect of the revocation is to nullify its prior action.¹³⁶ As a consequence, it is possible that the Commission could alter allocation formulas in "old" pools notwithstanding the courts' inability to do so. Needless to say, the likelihood of this result to any substantial extent is remote, although it was done in the Fairway Field subsequent to the *Normanna* decision.¹³⁷

In those cases in which the judiciary revokes a prior Commission order, the governing rule during the interim, if any, between the re-

¹³¹ Tex. Rev. Civ. Stat. Ann. art. 6049c, § 8 (1962).

¹³² *Alpha Petroleum Co. v. Terrell*, 122 Tex. 257, 59 S.W.2d 364 (1933); *Burford v. Sun Oil Co.*, 186 S.W.2d 306 (Tex. Civ. App. 1944) *error ref.*

¹³³ Section 2(g).

¹³⁴ "If conditions change, rights change, and the governing statutes place the matter of ascertaining such rights and determining the facts thereto in the first instance under the jurisdiction of the Railroad Commission." *Magnolia Petroleum Co. v. New Process Prod. Co.*, 129 Tex. 617, 104 S.W.2d 1106, 1111 (1937).

¹³⁵ Provided the subject matter of the change was considered at the previous hearing. *Magnolia Petroleum Co. v. New Process Prod. Co.*, 129 Tex. 617, 104 S.W.2d 1106 (1937); *Railroad Comm'n v. Shell Oil Co.*, 369 S.W.2d 363 (Tex. Civ. App. 1963), *aff'd*, 380 S.W.2d 556 (1964); *Railroad Comm'n v. Humble Oil & Ref. Co.*, 193 S.W.2d 824 (Tex. Civ. App. 1946) *error ref. n.r.e.*

¹³⁶ *Railroad Comm'n v. Miller*, 165 S.W.2d 504 (Tex. Civ. App. 1942).

¹³⁷ In *Pickens v. Railroad Comm'n*, 387 S.W.2d 35 (Tex. 1965), a 50% well-50% acreage formula had been issued prior to *Normanna*. After that latter decision the Commission withdrew its original order and instituted a 100% surface acreage allowable. In November and December of 1962 it held a new hearing and on March 6, 1963, promulgated the 50% surface acreage-50% acre-foot formula which was upheld by the supreme court.

vocation and the issuance of a new order must be determined. Article 6036a¹³⁸ provides for an emergency order to be issued in the Commission's discretion, upon application, and contemplates a hearing within fifteen days after issuance. The temporary order continues in force until the Commission issues its rule, regulation or order pursuant to the hearing, but in no case will the temporary order last longer than fifteen days. Such a brief period ordinarily would not suffice for the complete formulation of new orders,¹³⁹ but presumably in the future the Commission will gather information in advance to expedite the hearing, anticipating the possibility that the court will overturn the original order (in the one-third—two-thirds gas and fifty-fifty oil cases this is inevitable, absent unreasonable delay).

VIII. A CLOSER LOOK AT THE POOLING ACT

The result effected by the new Normanna Field Order¹⁴⁰ has been termed "judicial compulsory pooling" because the large-tract owner must either accept a reasonable pooling offer made by a small-tract owner or allow the latter the benefit of a somewhat liberal allowable. Although the supreme court has not yet expressly upheld the Normanna Order, it indicated an awareness thereof in the *Halbouty* opinion, which intentionally left a channel open for approval of the Normanna-type order.¹⁴¹ However, for several reasons this judicial pooling is unsatisfactory.

Most importantly, it makes possible the continued drilling of unnecessary wells, in contradiction of the fundamental Commission purpose of preventing waste. It is inequitable to *remote* large-tract owners who have no opportunity to protect themselves from drainage by pooling the small tract. Moreover, at least at the present time, it is uncertain whether the special allowables will be upheld in the supreme court. Furthermore, the system provides no fixed standards by which the Commission may determine if an offer to pool has been fair and reasonable, particularly with respect to percentage participation in income and expenses. Also, it may not be possible to force *lessors*, under leases without pooling clauses, to allow pooling of leased acreage under this arrangement.¹⁴² Since the right to drill is a prerequisite to the granting of an exception permit, the owner of

¹³⁸ Tex. Rev. Civ. Stat. Ann. art. 6036a (1962).

¹³⁹ For example, in *Normanna* the hearing was held on August 14, 1961, after notice, but the new field order was not issued until September 27, 1961.

¹⁴⁰ See note 60 *supra*.

¹⁴¹ See Hardwicke & Woodward, *Fair Share and the Small Tract in Texas*, 41 Texas L. Rev. 75, 96-99 (1962).

¹⁴² Colorado Oil & Gas Corp. v. Sears, 362 S.W.2d 396 (Tex. Civ. App. 1963) *error ref. n.r.e.*

the mineral rights in a tract which is the product of a "voluntary subdivision" is powerless to utilize the judicial compulsory pooling procedure¹⁴³ because the threat of *production* under a "special" allowable is the sole impetus to "voluntary" pooling. For the same reason, a small tract owner or his lessee who is financially unable to drill cannot force a pooling. At any rate, the basic conflict between rule of capture and ownership in place, manifest throughout, cannot be resolved except by statute. For some time authorities in this area have recommended the enactment of a compulsory pooling statute in Texas.¹⁴⁴

The existence of this slipshod system of judicially forced pooling, coupled with a great deal of compromising, finally engendered a pooling bill which encountered little opposition.¹⁴⁵ Decisions by the courts in this area had necessarily been *ad hoc* in nature, the courts considering and balancing all equities. In order to maintain the needed stability and at the same time provide definite, predictable standards, the legislature, on February 24, 1965, enacted the "Mineral Interest Pooling Act." The Pooling Act was thus the natural outgrowth of judicial pooling. It went into effect August 30 and will apply to all pools produced subsequent to March 8, 1961.¹⁴⁶ An important effect of the statute, as was true under the case law, will be the encouragement of *voluntary* pooling arrangements, since it continues the "reasonable offer to voluntary pool" prerequisite originated in the second Normanna order.¹⁴⁷ The incentive for large tract operators to take voluntary action is different, however, than under the old system. Previously, the stimulus was the fear of a small tract "special allowable," whereas now it will be the desire to "tailor-make" the

¹⁴³ This shortcoming also gives rise to inequities in "reconstituted tracts", as in *Ryan Consol. Petroleum Corp. v. Pickens*, 155 Tex. 221, 185 S.W.2d 201 (1956), which will be rectified under statutory compulsory pooling.

¹⁴⁴ Hardwicke & Woodward, *supra* note 141; Myers, Pooling and Unitization § 8.01(3) (Supp. 1963) (citing Professor Huie and William J. Murray, Chairman of the Railroad Commission, for similar proposals); A. W. Walker, Jr., speech delivered on September 29, 1964, before the Texas Mid-Continent Oil & Gas Association. Thirty-one states now have compulsory pooling or unitization laws.

¹⁴⁵ This is the TIPRO (Texas Independent Producers and Royalty Owners Association) Pooling Bill, approved September 15, 1964. This bill was adopted by the Committee for Equitable Development of Texas Oil and Gas Resources (CEDOT) on September 28, 1964. The Texas Mid-Continent Oil and Gas Association also favored compulsory pooling in general but not any specific proposal.

¹⁴⁶ Section 2(f).

¹⁴⁷ Section 2(a). See note 60 *supra* and accompanying text. The Act specifies certain provisions which would be per se unreasonable in either an offer to pool or a pooling order, to wit, the granting of preferential rights, calls, or options, district or central office charges and prohibitions against nonoperators questioning the operation of the unit. It should be noted that where the small tract owner is attempting to join a unit which is "equal to or in excess of the standard proration unit acreage for the reservoir," he must show not only that he has made "a fair and reasonable offer to voluntarily pool" but also that he has not been provided "a reasonable opportunity to pool voluntarily."

pooling arrangement without interference by the Commission and the Pooling Act. The substitution is a desirable one because it avoids the wasteful drilling of unnecessary wells, a major defect in the prior system. Furthermore, the small tract owner now has a means of recovering his fair share even if he is financially unable to drill an entire well or has no right to do so (*e.g.*, a voluntary subdivision).

Again following the Normanna Order, the statute allocates percentages of participation in production proceeds on a surface acreage basis in absence of special conditions;¹⁴⁸ this should be a reasonably simple system to administer. The fundamental concept from which the Pooling Act develops is the rather nebulous one of a "proration unit." Although there have been cases considering noncontiguous acreage to be within the scope of that term,¹⁴⁹ the newly added Rule 39(A) of the June 1, 1964, revision of Commission rules declares, "Proration and drilling units established for individual wells drilled or to be drilled shall consist of acreage which is contiguous."¹⁵⁰ Exceptions can and will be made, however, where unusual conditions warrant them. These will be more frequent with respect to the large gas units in areas containing tracts of irregular shapes and sizes, characteristic of Texas. In such limited circumstances it may be possible for an owner to improve his position by selective pooling with nonadjacent tracts in the common reservoir.

Another interesting provision follows the approach of its New Mexico counterpart. It gives nonconsenting owners (mineral owners not desirous of pooling their acreage but forced to do so at the instance of another owner) the option to pay their proportion of drilling expenses as incurred by the operator or to be carried by the operator, whose only recourse for expense reimbursement would be to actual production.¹⁵¹ In the latter instance, however, the operator is entitled to a "charge for risk" out of production in addition to actual expenses, as determined by the Commission, but not to exceed 100 per cent of all drilling and completing costs attributable to the non-drilling party's acreage.¹⁵²

The procedural steps for filing under the Pooling Act are relatively simple. The owner of acreage which "reasonably appears to lie within

¹⁴⁸ Section 2(d).

¹⁴⁹ See for example *Railroad Comm'n v. Williams*, 163 Tex. 370, 356 S.W.2d 131 (1962).

¹⁵⁰ Rule 39(A), Texas Railroad Comm'n Rules & Regs., § 1, at 19 (June 1964). However, this seems to have been the *practice* even before the adoption of this rule.

¹⁵¹ Section 2(d).

¹⁵² *Ibid.* It should be noted that the literal language of the statute would indicate that 100% of all drilling and completing costs could be added as a "charge for risk." However, this would be indeed unique among pooling statutes and will probably not result.

the productive limits of the reservoir,"¹⁵³ wherein the Commission has established field rules, enters his application for a proposed "pro-ration unit" and alleges that he has made a fair and reasonable offer to voluntarily pool. At least thirty days' notice must be given to all interested parties, which notice may be by publication in certain limited instances.¹⁵⁴ Thereafter, a hearing is held "upon such terms and conditions as are just and reasonable, and will afford to the owner or owners of each tract or interest in the unit the opportunity to produce or receive his fair share."¹⁵⁵ If the Commission finds that there has been a reasonable offer to pool and that drilling operations on the proposed unit are being prosecuted or are contemplated, it will issue a pooling order thereon. The unit is automatically dissolved, however, if no drilling operations have commenced within one year after the effective date of the order.¹⁵⁶ Suits contesting orders under this Pooling Act are not instituted in Travis County, where venue lies for contesting other Commission orders, but rather in the district court of the county in which the unit, or any part thereof, is located.¹⁵⁷

Although the question of reasonable time period for appealing *proration* and *exception permit* orders still exists, the Pooling Act specifies a thirty-day period for attacking orders "effecting pooling under this Act."¹⁵⁸ This constitutes an important step toward certainty not previously present in the statutes relating to appeals from administrative orders in this state. Furthermore, the Commission has no continuing jurisdiction in this area, because, in most instances, "[a] unit established by order of the Commission under . . . this Act may not subsequently be modified or dissolved without the consent of all parties affected. . . ."¹⁵⁹ This provision promises to present interpretive difficulties. Does it include modification of the provisions of the order itself or only the size and composition of the *unit*? The former interpretation, though problematical, will in all likelihood prevail.¹⁶⁰

¹⁵³ Section 2 (a).

¹⁵⁴ Section 2 (c).

¹⁵⁵ Section 2 (d).

¹⁵⁶ Section 2 (e). It is likewise dissolved six months after completion of a dry hole or cessation of production.

¹⁵⁷ Section 2 (g).

¹⁵⁸ *Ibid.*

¹⁵⁹ Section 2 (e).

¹⁶⁰ Substantial windfalls could result, for example, if it were later discovered that tracts of one or more unit members in fact lay outside the reservoir or contained substantially fewer acre-feet than originally estimated. The latter situation certainly could not be rectified. In the former, it could be argued that the original order was void *ab initio* by virtue of the language in § 2 (a): "When two or more separately owned tracts of land are embraced within a common reservoir. . . ." Nevertheless, the thirty-day time limitation on contests of orders under the Act might be raised as a defense.

Although the Pooling Act does provide substantial changes in the law, it is applicable only to pools discovered and produced after March 8, 1961, the date *Normanna* was handed down.¹⁶¹ Thus earlier-discovered pools still will be governed by the principles enunciated by the courts, and a future Rule 37 exception well remains a possibility. Post-*Normanna* pools, however, are encompassed by the Pooling Act, even to the extent of already producing wells. Nevertheless, a Rule 37 exception well could exist even in new pools should adjacent large tract owners refuse to pool.¹⁶² This fact should pose problems with respect to pools discovered between *Normanna* and passage of the Pooling Act, especially in connection with Rule 37 exception wells.¹⁶³ Although the Pooling Act is primarily designed for use by small tract owners, there seems to be no reason why a large tract operator with less than the standard "proration unit" could not implement the statute to pool a Rule 37 exception well in a post-*Normanna* reservoir. If he cannot, however, a very broad area for application of prior judicial authority would still exist. Thus, operators like Alcoa may still have a recourse in the Pooling Act, notwithstanding their unreasonable delay in contesting Commission orders under the previous system.

Petroleum law in Texas is entering a new era, and, as was true under "judicial compulsory pooling" subsequent to *Normanna*, the transition may prove problematical. Although there presently exists a theater in which the previously discussed judicial authority still is applicable, it is certain that a final clarification of the many intricacies of the Rule 37 exception well in Texas will never evolve.

¹⁶¹ Section 2(f).

¹⁶² The Commission might deny a permit on grounds that the compulsory pooling remedy is still available, but there is no evidence of any legislative intent that the statutory remedy be mandatory.

¹⁶³ Several possible combinations of problems exist. If a large tract and an exception tract adjoin, there may have been no wells drilled on either, in which case either party will probably have no trouble obtaining a compulsory pooling order. Difficulty increases where one tract does have a producing well, and the most problematical situation of all arises where both tracts contain wells. Applications in many of these last situations may quite possibly be denied.