Topic L13

Conservation Law and Regulation

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Review

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Ad Coelum Doctrine

Rule of Capture

- Correlative Rights
- Conservation Laws
- Fair Share Principle

Ad Coelum Doctrine

Review

- The ad coelum doctrine provides that a real property owner owns the surface and the subsurface all the way to the center of the Earth bounded on sides extending from the surface boundaries to the center.
- "The owner of the surface own[s] all beneath." - Del Monte Mining & Milling v. Last Chance Mining & Milling
- If you tunnel under the property line into my subsurface and take my minerals, I can sue to get them back.

Rule of Capture

Review

- The rule of capture modifies the ad coelum doctrine by providing that the landowner acquires ownership to the oil and gas extracted from the landowner's subsurface even if the oil and gas came from a neighboring property.
- "Whatever gets into the well belongs to the owner of the well, no matter where it came from." - Kelly v. Ohio Oil

Doctrine of Correlative Rights

Review

- The doctrine of correlative rights modifies the rule of capture by providing that a capturer is liable for waste or negligence that damages the common source of oil and gas.
- "due to the harsh consequences to neighboring land owners, Ohio law has evolved on this issue and the 'rule of capture' has been limited by the doctrine of correlative rights' - Barnes v. Res. Energy Expl. (Ohio App. 2016)

Fair-Share Principle

Review

- The fair-share principle modifies the rule of capture by providing that each mineral-rights holder must have a fair opportunity to get the oil and gas under the owner's surface.
- "The right to have a reasonable opportunity to produce one's just and equitable share of oil in a pool is [a] common-law right … " Wronski v. Sun Oil (Mich. App. 1979)
- Drilling too close to the property line "deprived plaintiff of the opportunity of claiming and taking the oil that was rightfully hers; and defendants must respond in damages for such conversion." Ross v. Damm (Mich. 1936)

Fair-Share Principle

Review

"Within reasonable limits, each operator should have an opportunity equal to that afforded other operators to recover the equivalent of the amount of recoverable oil (and gas) underlying his property. The aim should be to prevent reasonably avoidable drainage of oil and gas across property lines that is not offset by counter drainage. … This fair-share rule does not do away with the rule of capture, but rather acts to place limits on its proper application." - Wronski v. Sun Oil Co., (Mich. App. 1979) (quoting American Petroleum Institute)

Conservation Laws

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- Conservations laws use the state's police power to regulate drilling and production.
  - Examples:
    - Well-spacing rules
      - Well-spacing exceptions
    - Production regulation
    - Forced pooling
- In Texas, this regulation is done by the Railroad Commission.

Conservation Laws

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"States began developing petroleum conservation laws as the problems of unrestrained application of the rule of capture became apparent, exercising their police powers to internalize the external costs of the rule of capture. … Today, conservation laws are the keystone of the U.S. legal structure governing oil and gas development." - John S. Lowe, Oil & Gas Law in a Nutshell, 6th Ed.

"The primary purpose of oil and gas conservation statutes is to avoid physical and economic waste of oil and gas resources." *Id*.

Conservation Laws

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"Petroleum conservation laws work hand in hand with the correlative-rights doctrine to limit the rule of capture, transforming it to a 'fair share' doctrine; each owner is entitled to a fair chance to capture the oil and gas under his or her property." " - John S. Lowe, Oil & Gas Law in a Nutshell, 6th Ed.

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Ad Coelum Doctrine

Rule of Capture

Correlative Rights

Conservation Laws

Fair Share Principle

Conservation Laws

Why?

Because of the rule of capture.

Conservation Laws – why?

The rule of capture encourages people:

- to drill as close as possible to their property boundaries (to drain a neighbor's property and to protect against drainage from a neighbor's property), and
- to drill lots of wells near the property boundary, to maximize recovery area

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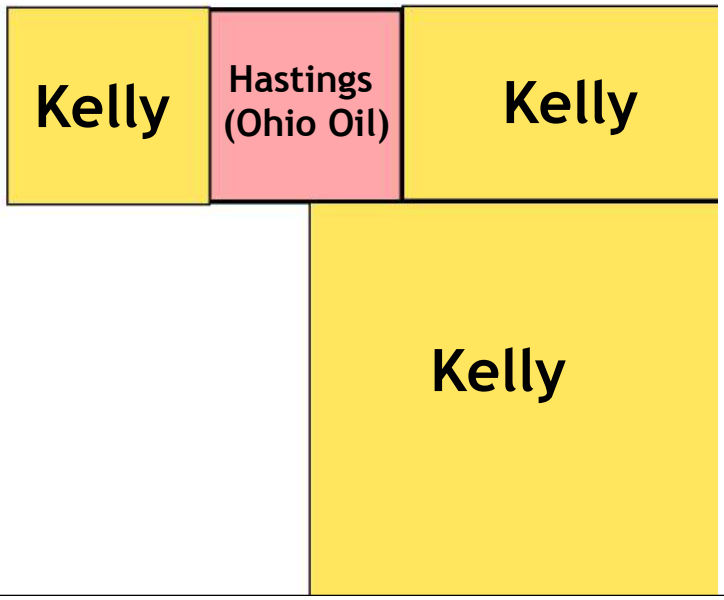
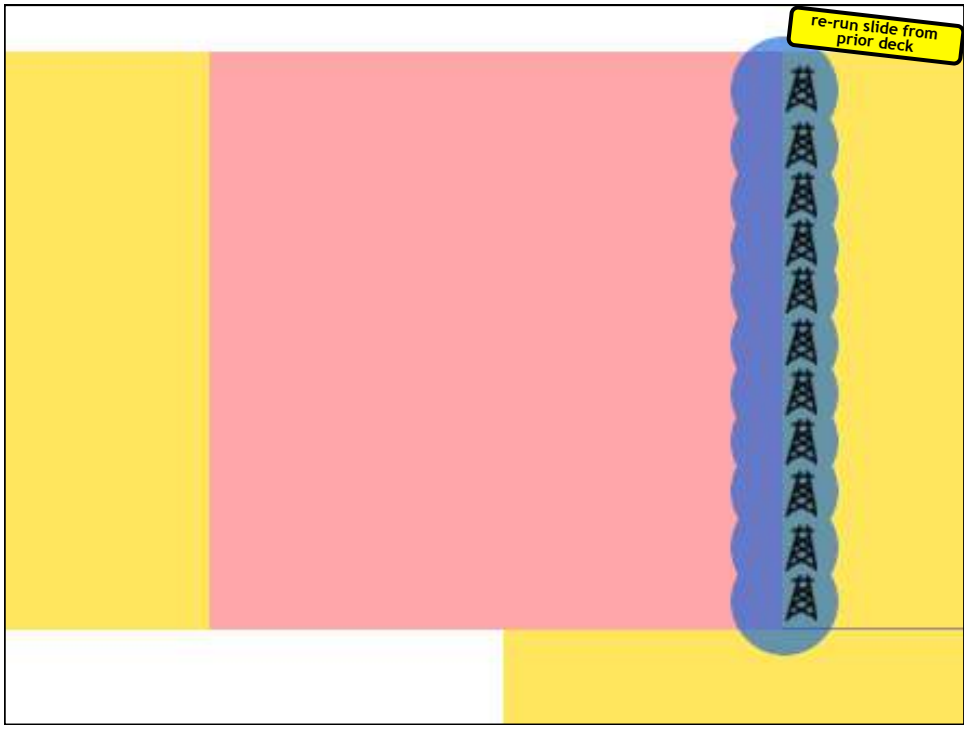
Kelly v. Ohio Oil





Conservation Laws – why?

The rule of capture encourages people:

- to drill as close as possible to their property boundaries (to drain a neighbor's property and to protect against drainage from a neighbor's property), and
- to drill lots of wells near the property boundary, to maximize recovery area, and
- as a general matter, to just drill lots and lots of wells - more than you would need to get all the oil slowly, because more wells equals faster recovery, and the rule of capture makes it a race

Conservation Laws – why?

Why isn't the doctrine of correlative rights enough?

- **The doctrine of correlative rights, as a common-law matter, provides rights for private parties to sue one another for "negligently" or "wastefully" using the rule of capture.**
- **For example, venting gas to the atmosphere, having a blowout and a fire, something like that actually destroys the hydrocarbons – not just taking more of them. Taking more is what the rule of capture is all about.**

Conservation Laws – why?

Why doesn't the market solve?

Here are some answers you could posit:

- **"What is harmful is the sum of these prudent individual actions." – John S. Lowe, Oil & Gas Law in a Nutshell, 6th Ed**
- **Collective-action problem**
- **Tragedy of the commons**
- **Externalities**
- **Transaction costs**

Conservation Laws - purposes

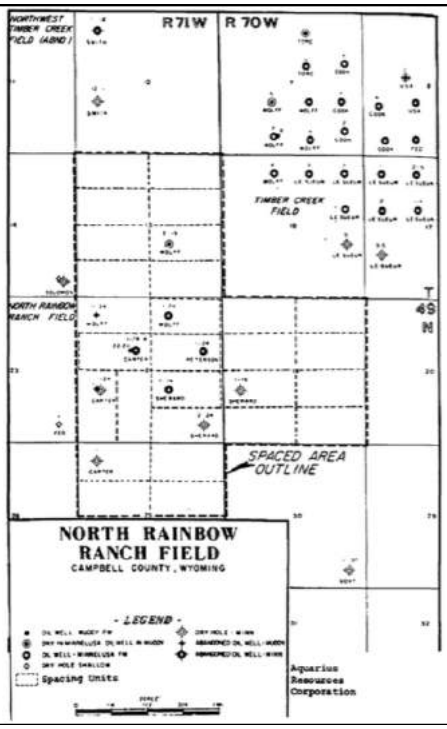
- Broadly, conservation laws are said to limit "waste"
  - economic waste – such as drilling more wells than is necessary to recover all the oil
  - physical waste – such as not making use of the natural pressure in the most advantageous way to avoid the need for pumping

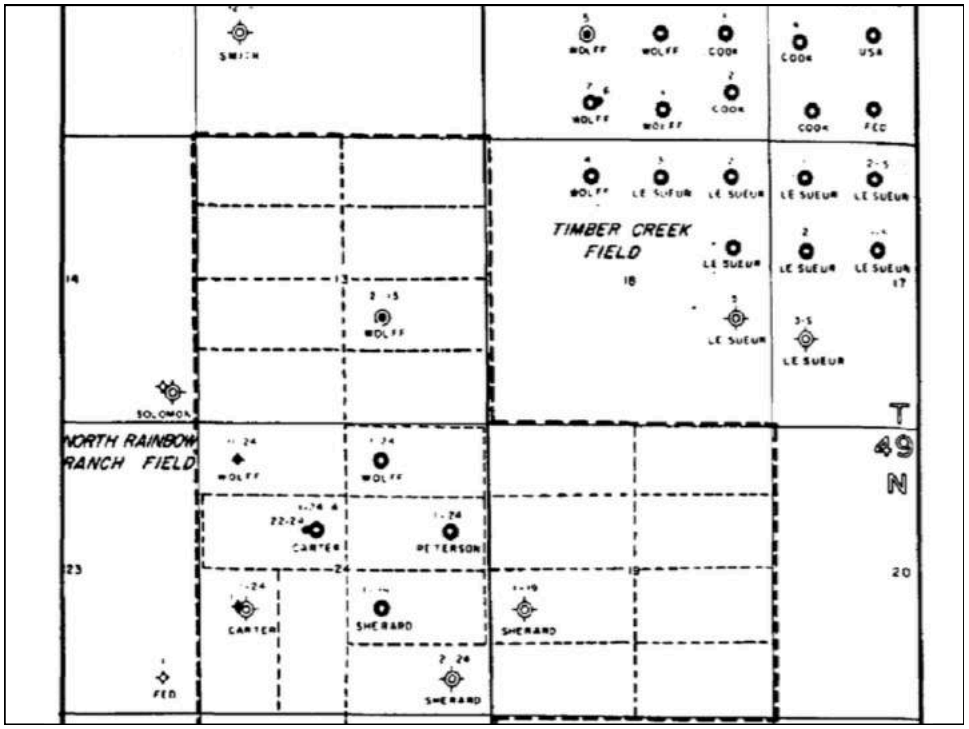
Some key kinds of conservation laws

- Well-spacing – mandating the spacing out of wells to efficiently produce a reservoir with the minimum number of wells necessary

Well spacing

- The idea is to figure out the minimum number of wells necessary to produce the economically producible oil
- This saves lessees money because it lowers production costs
- It probably doesn't save lessors money directly, because they mostly care about royalties, but it might benefit them indirectly assuming an efficient market for royalty rates.
- Well-spacing exception are granted by the governing commission

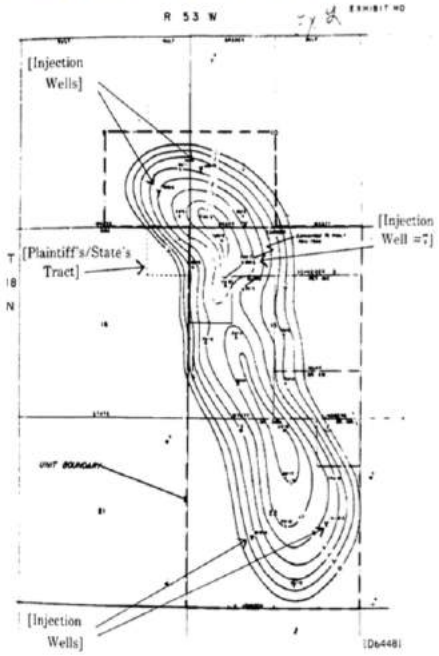




Well spacing exceptions

- Exceptions can be justified on the basis of:
- preventing waste
  - this can mean making sure there is a way to produce oil that wouldn't be recoverable if the well-spacing scheme was followed without exception
- "protecting correlative rights"

Kenmac offsets plaintiff's lease on the east and the north. Exhibit 2, which is reproduced herewith, shows the boundaries of Kenmac as well as the outline of the oil-bearing stratum involved herein:



Some key kinds of conservation laws

- Well-spacing – mandating the spacing out of wells to efficiently produce a reservoir with the minimum number of wells necessary
- Production regulation (a/k/a "prorationing") – limiting the amount of production per unit of time
  - maximum-efficient rate prorationing – to efficiently use the ground's natural capacity for pushing oil up to the surface (e.g., water drive) to prevent needless use of pumping
  - market-demand prorationing – to serve the articulated rationale of getting production to match demand
- Limiting venting or flaring off of gas – which otherwise would be done to get to oil faster
- Forced pooling – can be used to solve the "small-tract problem"