



# THE ATTORNEY GENERAL OF TEXAS

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May 17, 1973

The Honorable Max Sherman  
Senate of the State of Texas  
Austin, Texas

Letter Advisory No. 41

Re: Various questions  
concerning House  
Bill 311 - Compulsory  
Unitization

Dear Senator Sherman:

As Chairman of the Senate Committee on Natural Resources you have sent us House Bill 311 asking various questions concerning its constitutionality. The Bill would establish comprehensive procedures by which the Railroad Commission (hereafter merely the Commission) might order the unitization of producing operations in oil and gas reservoirs if the Commission finds, among other facts, that the unitized operation is "economically feasible and reasonably necessary to prevent waste" and provides a plan "for the purpose of increasing the ultimate recovery of oil or gas or both . . ." It has no application to mineral exploration or to refining or marketing of petroleum or petroleum products.

Generally, after a statement of the power and authority of the Commission, (§ 1), and definitions (§ 2), the Bill, in § 3, defines the requisites of a petition to be filed with the Commission requesting an order for the unitized operation of a common reservoir or portion of one. Upon receipt of the application, the Commission may require, after hearing, that other information be furnished.

Section 4, requires findings as to whether certain conditions exist: (1) The economic feasibility and reasonable necessity of unitization to prevent waste; and that the plan submitted provides for unitized operations for the purpose of increasing ultimate recovery of oil or gas or both; (2) That the value of additional recovery under unitization will exceed additional cost; (3) That the proposed plan is fair, reasonable and equitable to all owners and that reasonable efforts have been made to form a voluntary group; (4) That expense incurred in establishing the unit is reasonable and necessary; (5) That the limits of the reservoir have been defined and the area proposed is reasonably necessary

and sufficient; (6) That the necessary percentage of working interest owners have signed the plan; and (7) That the plan meets the requirements of § 5. If the Commission finds all these conditions exist, it shall give a unitization order which will unitize the interests of all persons in the unit area whether or not such persons have approved the plan of unitization.

The next section, § 5, prescribes in great length the contents of the Commission's orders. Among the subjects covered are the area of the common reservoir; designation of a working interest owner to act as unit operator, with provisions for his resignation and removal and consequent replacement; certain provisions in the unitization plan; factors to be used in determining a tract's participation in production and benefits; the manner of financing and apportioning expense; a plan for financing the share of unit development cost for those who elect to be carried; a method for a working interest owner to withdraw and the disposition of his interests or for a nonsigning working interest owner to assign or sell his interest or relieve himself of further liability for operations; provisions for reports and accounting for costs and expenses to any working interest owner upon request; the right to audit; methods for equalizing investment; provisions for voting rights and limitations on them; the effective date of the plan; termination provisions; public notice provisions; protection of employee's interest; and anti-discrimination provision.

Section 6 provides that no order of the Commission creating a unit shall become effective unless and until the plan is approved by the Commission and by the owners, on a tract participation basis, of at least 75% of the aggregate unit working interests or by owners, on a tract participation basis, of at least 75% of the aggregate unit royalty interests.

Section 7 contains certain notice provisions when an application is filed at least 30 days prior to the Commission hearing, and § 8 provides for an appeal be a trial de novo in the district court of the county in which the land is located.

Section 9 covers unit expenses, which are several and not joint, and provides that the unit operator may have a lien and security interest upon the leasehold estate of each working interest owner and nonoperating interest owners shall have a lien upon the leasehold estate of the unit operator. The owners of royalty interests shall have a lien upon certain working interest owner's properties.

Section 10 expressly provides that no unitization under the Act would affect the title of any person in or to any tract of land involved in the unitization or relieve working interest owners from their obligation to reasonably develop the land and lease in the unit. Further, it provides that production or proceeds from the sale thereof shall not be treated as profit of the unit and provides for a method of distribution of the production. It further provides that each working interest owner shall reserve the right to take in kind and to separately market unit production attributable to his interest. It provides in subsection (i):

"The provisions of the Act shall be applicable to all land owned by the State of Texas or any of its political subdivision or agencies . . . . provided however, that whenever land or minerals owned by the State of Texas or any political subdivision or agencies thereof lies within the proposed unit area, the plan of unitization must be approved by the appropriate State agency or Board having jurisdiction over such lands or minerals before such lands or minerals may be included in the unit."

Sections 11 and 12 deal with enlargement of units and amendments to the plan of unitization and the Commission order.

Section 14 directs that no agreement pursuant to the Bill and for the purpose of bringing about unitized operations shall be held to violate any anti-trust or anti-monopoly statute of the State. Existing unit agreements or those in process of being executed are dealt with in § 15.

The Emergency Clause, found in § 16 is as follows:

"The importance of this legislation to conserve the oil and gas wealth of this state, to aid in the efficient and economic extraction of such oil and gas, to provide safeguards for the rights of all owners of interests therein, to prevent physical waste of oil and gas, to prolong the life of oil and gas fields, to increase the overall income of royalty owners of which the State of Texas is one, to increase and prolong the tax revenues of taxing agencies in the state, by which every school child, for example, will be materially

benefited, as well as the crowded condition of the calendars in both houses, create an emergency and an imperative public necessity that the constitutional rule requiring bills to be read on three separate days in each house be, and the same is hereby, suspended, and that this Act take effect and be in force from and after its passage, and it is so enacted."

Your first question is:

"Do the provisions of House Bill 311 conflict with Texas' anti-trust laws? May the Texas Legislature constitutionally provide such an exemption from the anti-trust laws? "

In answering these questions we limit ourselves to the formation of these units and express no opinion related to or as an interpretation of the possible future acts of the principals in such units.

Texas' anti-trust laws are found in Chapter 15 of the Business and Commerce Code, V. T. C. S. They prohibit agreements for pooling, combining, or uniting other interests in connection with the sale or purchase of any commodity so that the price of such commodity might be in any manner affected or agreements to regulate the output of any commodity or the amount of work performed in preparing such commodity for market or to combine to "restrict or tend to restrict commerce" or "prevent or lessen competition" in the sale or purchase of commodities or "affect the cost of preparing property for market."

That a unitization plan, as contemplated by this Bill, will have the effect of decreasing or lessening competition and will act to some extent as a restraint on trade in connection with the production or preparing for market of oil and gas under such units, is virtually self evident. Whether such plans, in practice, will have other effects at odds with other provisions of our anti-trust laws, it is unnecessary to this opinion to discuss. In all events, we conclude for the purposes of this opinion, that such plans, absent a constitutionally valid exemption, would violate our State anti-trust laws.

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The remaining portion of your first question is "May the State exempt such plans from the operation of the State anti-trust laws?" After a careful examination of the applicable authorities, we have concluded that the answer to that question is "Yes." In making this answer, we are not, of course, passing upon the desirability of such an exemption. The determination of the policy for granting or withholding such an exemption is well established. The Legislature has the right, within the exercise of its power, to make certain classifications of objects and persons so as to create exemptions, but such classifications must not be arbitrary or unreasonable so as to violate the equal protection guarantees of our State and Federal Constitutions. As was said by the Supreme Court of Texas in Railroad Commission v. Miller, 434 S. W. 2d 670 (Tex., 1968):

" . . . A state may classify its citizens into reasonable classes and apply different laws, or its laws differently, to the classes without violating the equal protection clause of the Fourteenth Amendment. Bjorgo v. Bjorgo, 402 S. W. 2d 143 (Tex. Sup., 1966).

"The test is whether there is any basis for the classification which could have seemed reasonable to the Legislature. San Antonio Retail Grocers, Inc., v. Lafferty, 156 Tex. 574, 297 S. W. 2d 813 (1957). A classification is reasonable if it is based on a real and substantial difference having relationship to the subject of the particular enactment and operates equally on all within the same class. State v. Richards, 157 Tex. 166, 301 S. W. 2d 597 (1957)." (434 S. W. 2d at 673).

See also, McGowan v. Maryland, 366 U. S. 420, L. Ed. 2d 393, 81 S. Ct. 1101 (1961).

This very question was considered in Hollingsworth v. Texas Hay Ass'n., 246 S. W. 1068 (Tex. Civ. App., Galveston, 1923, err. ref'd.) where the Cooperative Marketing Act of 1921 provided:

"No association organized hereunder shall be deemed to be a combination in restraint of trade or an illegal monopoly; or an attempt to lessen competition or fix prices arbitrarily; nor shall the marketing contracts or agreements between the association and its members nor any agreements authorized in this Act be considered illegal or in restraint of trade."

The court summarily dismissed the complaint that a contract under the Act contravened the anti-trust laws saying:

"We know of no constitutional reason why the public policy of the state may not be so declared." (246 S. W. at 1070) and see Parker v. Brown, 317 U. S. 341, 87 L. Ed. 315, 63 S. Ct. 307 (1943) holding that the Federal anti-trust laws (15 U. S. C., §1, et seq.) were not intended to restrain State directed action.

In 1947, this office had before it, prior to its enactment, a proposed bill to allow for agreements for cooperative exploration of oil and gas properties. Its opinion was asked as to whether such bill would violate the anti-trust laws. Now Chief Justice Joe Greenhill, then an Assistant Attorney General, wrote the opinion [V-97 (1947)] holding that, were the bill limited to operations necessary for the conservation of natural resources the exception to the anti-trust laws would be upheld.

The bill was then amended limiting itself to situations when necessary to prevent the waste of oil and gas. Justice Greenhill, in a supplementary opinion [Attorney General Opinion V-97-A (1947)] dealing with a bill with many provisions similar to the one at hand including the anti-trust exemption, held the bill to be constitutional and predicted it would be upheld by the courts. It should be noted however that the bill provided that it, rather than the anti-trust laws, would be held invalid if any court should find a conflict.

It is our opinion, therefore, that the State may exempt from the operation of State anti-trust laws, unitization plans of producing operations created pursuant to the Railroad Commission order contemplated by House

Bill 311 and pursuant to the findings which must be made as a predicate thereto. Such plans must be for the necessary conservation and "increasing the ultimate recovery" purposes there mandated. The Legislature may desire, however, to give some consideration to language such as Judge Greenhill considered in his opinion giving precedence to the anti-trust laws in the event of an irreconcilable conflict.

Your second question asks: "Can the Texas Legislature constitutionally exempt public lands from the application of the Act as provided under § 10 (i)?"

House Bill 311 provides that State lands shall be included in a unit subject to first securing the approval of the appropriate State agency or Board having jurisdiction of the land.

The constitutional problem with exempting some land from the scope of the Act involves constitutional rights to equal protection guaranteed by the Fourteenth Amendment to the United States Constitution and to equal rights guaranteed by Article 1, § 3 of the Texas Constitution. The controlling principles were stated by the Supreme Court of Texas in Railroad Commission v. Miller, supra. See also, McGowan v. Maryland, supra.

We are unable to say that the Legislature could not have found reasonable grounds for excluding State owned lands from unitization without approval of the agency or board having jurisdiction over the land. The office of the Land Commissioner is a constitutional office (Article 4, § 1). He is to perform such duties as are required by law (Article 4, § 23), and he is given general jurisdiction over all State lands (Article 5251, V. T. C. S.). Nor is it unusual to exempt State lands from the scope of general laws. They are not subject to ad valorem taxation. Article 8, § 2, Constitution of Texas; Article 7150 (4), V. T. C. S. Normally, statutes of limitation do not run against them, Article 5517, V. T. C. S. State owned property is exempted from zoning ordinances. Port Arthur Independent School District v. City of Grover, 376 S. W. 2d 330 (Tex., 1964). Whether it is wise to keep State lands from unitization is a legislative decision which we cannot review. It is our opinion that the Legislature may so provide, and that the statute is not unconstitutional on that ground.

Your third question is:

"Would the provisions of House Bill 311 permitting compulsory unitization of public lands, unless the appropriate governing authority disapproves, conflict with existing statutes permitting the State to take its oil and gas in kind? What would be the effect on the State's rights to take in kind, or at fair market value at the wellhead? "

Section 10 (c) of House Bill 311 provides "except as may be authorized in this Act or in the plan of unitization" the amount of unit production allocated to each tract shall be distributed "upon the same conditions" had not the unit been established. We understand this to mean that, to the extent any royalty owner is entitled to receive his royalty in kind under his lease, he will continue entitled to so receive it unless otherwise authorized by the plan. Section 10 (d) however, expressly provides that those entitled to take "in kind" by contract or otherwise shall continue to be so entitled. We are advised that the Legislature is presently granting the State the right to take its oil and gas in kind, and it is our opinion that, to the extent the State may be entitled "to take its oil and gas in kind", House Bill 311 can provide that its passage will not effect such entitlement. It is, of course, for the Legislature to determine whether such entitlement shall be without exception or subject to change by the unitization plan. The legislative intent in this regard can be and should be clearly stated.

Your fourth question is:

"Do the provisions of this bill providing that the Railroad Commission may order the unitization of fields or portions thereof if 75% of the working interest owners and 75% of the royalty interest owners approve constitute an unconstitutional taking of private property? "

Article 1, §17 of the Texas Constitution provides, in part: "No person's property shall be taken, damaged or destroyed for or applied to public use without adequate compensation being made, unless by the consent of such person . . ."

House Bill 311, §§ 5(i)(1) and (2) does provide for the nonworking interest owner to relieve himself from further liability for unitized operations. He may (1) assign his interest to the unit operator, who within 60 days shall pay the net value of the interest after deducting the cost of equipment attributable to that interest or he may (2) offer to sell his interest to other working interest owners at an agreed price. If there is no such agreement, the price will be determined by arbitration. But, the Bill goes on to provide, if either side is dissatisfied with the price so determined, there may be an appeal to the district court of the county in which the unit is located for a determination of the value in the same manner as value is determined in condemnation proceedings. It provides that the purchasing working interest owners may deposit the sale price determined in arbitration or post an approved security and take possession of the interest and proceed with unitization.

These provisions, we think meet procedural requirements of Article 1, § 17.

The declared public purposes of compulsory unitization, under House Bill 311, are conservation, prevention of waste and increasing tax revenues. The power of the State to enact laws in the general welfare, including oil and gas regulation is founded upon the police power of the State. The right to restrict the number of wells, to regulate spacing, and to limit production have been upheld as proper waste prevention measures. Brown v. Humble Oil & Refining Co., 83 S. W. 2d 935 (Tex., 1935), and cases cited. Similarly, it would seem that the stated purpose of House Bill 311 - "for the conservation of oil and gas" - is a public use, as required by § 17 of Article 1, and that the Bill, if enacted would meet all the substantial requirements of the "public use" portion of the constitutional provision. Davis v. City of Lubbock, 326 S. W. 2d 699 (Tex., 1959).

As Justice Greenhill pointed out in the Davis case, whether a taking of property is for "public use" is a judicial question but the court will give "great weight" to the legislative determination.

Turning next to the matter of "adequate compensation," we recognize that the potentials exist under the practical application of such a unitization plan for less than full and absolute assurance of fair market value being received for the interest of an owner who does not desire to enter the plan and desires to sell. Such a person has no absolute control over the

ultimate value he will receive for his property whether he sells before or after entering the unit. However, there is no true "taking" in the literal sense of the word although the practical effects could in some instances be the same.

In passing on the constitutionality of such unitization plans, the courts apparently have not made any such distinctions or analyses and have rested their constitutional approval generally under the police power.

In Myers, The Law of Pooling and Unitization, (2d Ed., 1967), the constitutionality of compulsory unitization is analogized to the constitutionality of compulsory pooling. As long ago as 1944 in Klepak v. Humble Oil Refining Co., 177 S. W. 2d 215 (Tex. Civ. App., Galveston, 1944) compulsory pooling was upheld, under a town ordinance which districted the town into drilling blocks and limited drilling to one well per block. The Galveston court in upholding the action of the town said that it had a fundamental right, under the police power, to regulate the drilling of wells within the corporate limits "when acting for the protection of their citizens and the property within their limits, looking to the preservation of good government, peace, and order therein . . . ." (177 S. W. 2d at 218).

Article 6008(c), V. T. C. S., The Mineral Interest Pooling Act, also empowers the Railroad Commission to order compulsory pooling or unitization. The Act has been enforced despite constitutional attack. It has not been attacked however on the specific ground that it constituted an unconstitutional taking. Railroad Commission v. Miller, supra. Justice Brandeis, speaking for the Supreme Court in Thompson v. Consolidated Gas Co., 300 U. S. 55, 81 L. Ed. 510, 57 S. Ct. 364, (1937), and in upholding the plaintiff's position that the Texas statute was invalid said:

" . . . It may be assumed that House Bill 266 should be construed as authorizing regulations to prevent waste, and to create and protect correlative rights of owners in a common reservoir of gas to their justly proportionate shares thereof, free of drainage to neighboring lands. It may be assumed, also, that the statute, so construed, is a valid exercise of the State's undoubted power to legislate to those ends; and that it validly delegates to the Railroad

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Commission authority to promulgate regulations therefor. It is settled that to all administrative regulations purporting to be made under authority legally delegated, there attaches a presumption of the existence of facts justifying the specific exercise. . . . " (300 U. S. at 69)

See also Bandini Co. v. Superior Court, 284 U. S. 8, 76 L. Ed. 136, 52 S. Ct. 103, (1931).

The exercise of other police powers has similarly been upheld against the contention that it constituted a taking of private property without compensation. Ohio Oil Company v. Indiana (No. 1), 177 U. S. 190, 44 L. Ed. 729, 20 S. Ct. 576 (1900); Champlin Refining Co. v. Corporation Commission of Oklahoma, 286 U. S. 210, 76 L. Ed. 1062, 52 S. Ct. 559 (1932).

Oklahoma was the first state to enact a Unitization Act (Session Laws, 1945, Title 52, Ch. 3b). It was first tested in Palmer Oil Corporation v. Phillips Petroleum Company, 231 P. 2d 997 (Oklahoma, 1951) app. dis'm. 343 U. S. 390, 96 L. Ed. 1022, 72 S. Ct. 842, (1952). There have been, since then, numerous attacks on the Oklahoma statute but none have been upheld. See Myers, Op. Cit., § 8.02, p. 290-295.

Compulsory unitization statutes are now common in a great number of states and are generally upheld as to constitutional questions essentially parallel to those involved in your fourth question. Myers, Op. Cit. § 8.02(3), p. 287-288.

It is our opinion, therefore, that House Bill 311, if enacted into law, would probably withstand a constitutional attack predicated on Article 1, § 17 of the Texas Constitution.

Your fifth question asks: "Do you find any section of the bill to be constitutionally impermissible?"

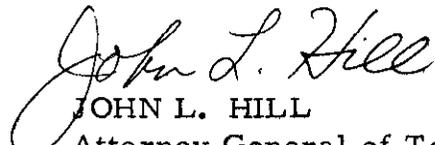
The Bill is very detailed and is some thirty-three pages in length. While we have studied it with care, the time allotted to us to prepare this opinion would not warrant that we express an opinion purporting to cover all of its provisions.

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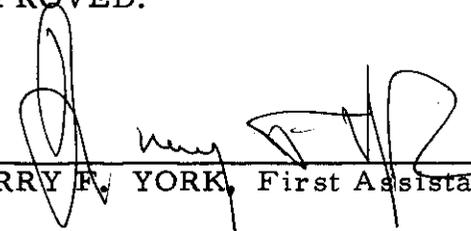
One provision which did come to our attention and has caused us some concern is the last sentence of § 8 providing that, on appeals from orders of the Commission effecting or denying unitization, the proceedings before the district court "shall be conducted as a trial de novo."

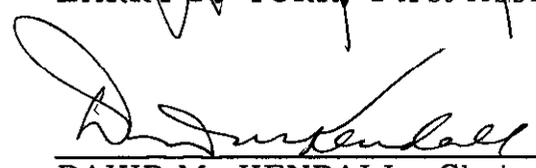
It is our opinion that whether or not an oil and gas reservoir should be unitized is a decision calling for legislative discretion - a decision which the Legislature may delegate to an administrative agency under sufficient standards, but which may not be delegated to the judiciary. Chemical Bank and Trust Co. v. Falkner, 369 S. W. 2d 427 (Tex., 1963); Davis v. City of Lubbock, supra.

Very truly yours,

  
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APPROVED:

  
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