

# Exploring Past, Present, and Future Roles for Correlative Rights in Arkansas Oil and Gas Conservation Law

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## I. BEFORE THE CONSERVATION LAWS

### A. *Hague v. Wheeler*, 157 Pa. 324, 27 A. 714 (1893).

1. Private rights prevail over public rights.
2. Correlative rights *of the wasting party* protected by the Pennsylvania Supreme Court.
3. Finally, an effective gas balancing remedy.
4. “In the disposition he may make of it [gas from defendant’s well] he is subject to two limitations: he must not disregard his obligations to the public, *he must not disregard his neighbor’s rights.*”
5. Here the “neighbor’s rights” were recognized by the wasting party’s offer to sell gas to them.
6. For a critique of commentator analysis of *Hague* see: David E. Pierce, *Carol Rose Comes to the Oil Patch: Modern Property Analysis Applied to Modern Reservoir Problems*, 19 PENN ST. ENVTL. L. REV. 241, 257-59 (2011).

### B. *Ohio Oil Co. v. Indiana*, 177 U.S. 190 (1900).

1. Protection of correlative rights of private owners relied upon to support state law protecting public rights.
2. Prevention of “waste” accomplished by efforts to protect correlative rights of other property owners in the reservoir where Ohio Oil was operating.

### C. *Bandini Petroleum Co. v. Superior Court of California*, 284 U.S. 8 (1931).

1. Enforcing California’s “Oil and Gas Conservation Act” the state enjoined the “unreasonable waste of natural gas.” *Id.* at 104.
2. The lower court “thought it doubtful whether the state might restrict or regulate the production of oil or gas ‘on the theory of the public’s interest in their natural resources,’ . . . .” *Id.* at 108.

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3. The U.S. Supreme Court relied upon a private correlative rights theory to support the state's action observing:  
  
"If the statute be viewed as one regulating the exercise of the correlative rights of surface owners with respect to a common source of supply of oil and gas, the conclusion that the statute is valid upon its face . . . is fully supported by the decisions of this Court." *Id.*

## II. BEFORE THE 1939 CONSERVATION LAW

### A. Discovery!

1. **1921, El Dorado.** "The historic south Arkansas oil boom began on January 10, 1921, with completion of the Busey No. 1 well . . . one mile southwest of El Dorado, that produced a gusher well that sprayed 3,000 to 10,000 barrels of oil up to a mile away."  
  
THE ENCYCLOPEDIA OF ARKANSAS HISTORY & CULTURE,  
<http://www.encyclopediaofarkansas.net/encyclopedia/entry-detail.aspx?entryID=383> (last visited Aug. 23, 2014).
  - a. Production in 1921 following discovery (in barrels):  
March (38,000), April (325,000), May (578,000), June (908,000)
  - b. By 1922 900 wells were in operation.
2. **1922, Smackover.** "Smackover, like El Dorado, also swelled with oil workers and fortune seekers. Its population surged to 25,000 within a few months in 1922 from a mere 131. The oil-producing area of the Smackover Pool covered more than 25,000 acres and, by 1925, had become the largest-producing oil site in the world. The Smackover Pool would eventually produce 583 million barrels of oil by 2001." *Id.*
  - a. By 1925 there were 3,483 wells that produced, in a single year, 73 million barrels of oil.
  - b. Trains could not transport all the oil out of the field; turned to earthen pits for storage.

### B. Regulation.

1. Who is regulating oil and gas development?
  - a. **1899**, Arkansas Railroad Commission created.
  - b. **1919**, Arkansas Corporation Commission created to succeed the Railroad Commission.
  - c. **1921**, Corporation Commission abolished; Railroad Commission recreated.

- d. **1933**, Railroad Commission abolished; Corporation Commission recreated.
  - e. See Arkansas Public Service Commission website, Commission History, <http://www.apscservices.info/commission-history.asp> (last visited August 23, 2014).
2. Arkansas Railroad Commission in power when the El Dorado and Smackover fields were in full production.
  3. In **1917** Arkansas passed statutes to limit the waste of natural gas, to require the use of casing, and imposing abandoned well plugging requirements.  
Blakely M. Murphy, *The Legislative and Administrative Concept of Oil and Gas Conservation in Arkansas, 1917-1947*, 1 ARK. L. REV. 236, 236 (1947).
  4. In **1921** a law was passed to limit over-production and waste of natural gas, but it failed “to establish an effective conservation measure” to deal with the El Dorado Field problems. Murphy at 237.
  5. In **1923**, the first Arkansas “conservation” law was passed, titled: “An Act to conserve crude oil or petroleum and natural gas . . . .”
    - a. The Act was approved March 23, 1923 and granted the Arkansas Railroad Commission authority to “promulgate rules and regulations to further conserve crude oil and natural gas and regulate the production thereof . . . .”  
FEDERAL OIL CONSERVATION BOARD, THE OIL AND GAS CONSERVATION STATUTES, 33-39 (1933) (compiled by Northcutt Ely).
    - b. The situation leading up to the 1923 Act was described by one commentator as follows:  
 “With the discovery of the famous Smackover Field in late 1922 waste control took a holiday within the State. Millions of barrels of oil were permitted to run uncontrolled into streams, creeks and rivers surrounding that area. Gas was allowed to blow into the air – the theory being that it was only an incident in the production of oil. Fires visible for fifty miles burned unchecked for long periods. The State of Arkansas and its officials were powerless to cope with the task of regulating the hundreds of new wells being drilled.” Murphy at 237.
  6. The Act of **1925** transferred regulation from the Arkansas Railroad Commission to the office of Commissioner of Conservation and Inspection, “[l]argely to create new and additional gubernatorial appointments.” Murphy at 238.

7. The Act of **1927** placed the administration of oil and gas production “in the hands of an honorary board known as the State Board of Conservation.” Murphy at 238.
8. The Act of **1933** created the Arkansas Board of Conservation. “Qualifications for membership were knowledge and experience in the oil and gas industry and in the production and refining of oil and natural gas. A headquarters office was established in El Dorado.” Murphy at 238.

### C. Correlative Rights

1. It appears that under the early “conservation” laws the concept of “waste” focused as much on the recognized “private” aspects of correlative rights as it did on the “public” aspects of the prevention of waste.
  - a. This is consistent with the early analysis applied by the United States Supreme Court when evaluating the Indiana statute regulating the release of gas in *Ohio Oil Co. v. Indiana*.
  - b. Separate statutes also address the ratable take aspects of correlative rights; ratable take issues would come to dominate future definitions of “waste” as well as the correlative rights concept.
2. **Act 664 of 1923, §1:** “[I]t shall be unlawful for natural gas, crude oil, or petroleum to be produced in this State in any manner or under any such conditions as to constitute waste.”
3. **Act 664 of 1923, §2:** “The term ‘waste’ as above used, in addition to ordinary meaning, shall include (1) escape of natural gas in commercial quantities into the open air; (2) the intentional drowning with water of gas stratum capable of producing gas in commercial quantities; (3) underground waste; (4) the permitting of any natural-gas well to wastefully burn; and (5) the wasteful utilization of such gas; . . . .”
  - a. Note that all of these issues are of the type addressed by the Court in *Ohio Oil Co. v. Indiana*.
  - b. The Act was focusing on the problems of the day: wasting gas to produce oil.
4. **Act 664 of 1923, §4** (restrictions of production to “market demand”) and **§5 & §6** (pipelines must act as common purchasers and cannot discriminate in taking gas).

The text of the 1923 law can be found at: FEDERAL OIL CONSERVATION BOARD, THE OIL AND GAS CONSERVATION STATUTES, 33-39 (1933) (compiled by Northcutt Ely).

5. The primary focus of the pre-1939 conservation acts was to protect the natural gas resource from being destroyed in the process of producing oil.

### III. AFTER THE 1939 CONSERVATION LAW

#### A. Creation of the Arkansas Oil and Gas Commission

1. For a detailed account of the origin of the 1939 Act, and the main participants in its creation, see: Blakely M. Murphy, *The Legislative and Administrative Concept of Oil and Gas Conservation in Arkansas, 1917-1947*, 1 ARK. L. REV. 236, 239-40 (1947).
2. The 1939 Act is also discussed in: SECTION OF MINERAL LAW, AMERICAN BAR ASSOCIATION, CONSERVATION OF OIL & GAS, A LEGAL HISTORY, 1948, 32-34 (1949) (Blakely M. Murphy, editor).

#### B. New Definition of “Waste”

1. Recall the 1923 Act’s waste definition focused on the waste of the gas resource.
2. The 1939 Act focuses on the waste of oil and gas.
3. Notably, the definition also includes: “Abuse of the correlative rights and opportunities of each owner of oil and gas in a common reservoir due to non-uniform, disproportionate, and unratable withdrawals causing undue drainage between tracts of land.” Blakely M. Murphy, *The Legislative and Administrative Concept of Oil and Gas Conservation in Arkansas, 1917-1947*, 1 ARK. L. REV. 236, 240 (1947).
  - a. “Abuse of the correlative rights and opportunities of oil and gas in a common reservoir” is a very broad statement of correlative rights. However, this statement is limited by the “due to” language which relegates correlative rights to matters associated with ratable production to avoid undue drainage.
  - b. This limited definition of correlative rights is carried forward, without change, to the present statutory definition. ARK. CODE ANN. § 15-72-102(15)(C) (2009).
  - c. The same definition is used in the Commission’s regulations. ARK. OIL AND GAS COMM’N, GEN. RULES AND REGS., RULE A-4: DEFINITIONS, WASTE(3), 18 (Jan. 20, 2014).
4. In the Act’s “Declaration of policy” the Legislature noted:

“In recognition of past, present, and imminent evils occurring in the production and use of oil and gas as a result of waste in the production and use thereof in the absence of coequal or correlative rights of owners of crude oil or natural gas in a common source of supply to produce and use the crude oil or natural gas, this law is enacted for the protection of public and private interests against such evils by prohibiting waste and compelling ratable production.”

ARK. CODE ANN. § 15-72-101 (2009).

- a. Correlative rights are again referenced in the context of addressing the inability of all owners to “produce and use” the oil and gas.
- b. The closing phrase refers to “prohibiting waste and *compelling ratable production.*”

#### IV. CORRELATIVE RIGHTS AND THE ARKANSAS COURTS

##### A. Oil and Gas

1. Although the Arkansas Oil & Gas Commission has been creative in seeking to prevent waste and protect correlative rights, the courts have not been very accommodating.
2. For example, in *Dobson v. Arkansas Oil & Gas Commission*, 235 S.W.2d 33 (Ark. 1950), the Commission sought to unitize the McKamie-Patton field to control the destructive waste of gas that could impair the rights of all owners in the field. The court, noting the state of the law in 1950, concluded “the goal of field-wide unitization can be reached only by voluntary co-operation.” *Id.* at 36.
3. One court appeared willing to use trespass to police movement of reservoir contents beneath surface boundaries. *Hill v. Southwestern Energy Company*, Case No. 4:12-cv-500-DPM, 2013 WL 5423847 (E.D. Ark. Sept. 26, 2013) (denying motion to dismiss trespass claim relating to alleged migration of fluids, within the injection formation, in permitted injection well).
4. As Thomas Daily has noted: “Please remember though, correlative rights are not common law rights; they are one hundred percent statutory.” Thomas A. Daily, *Lawyering the Fayetteville Shale Play – Welcome To My World*, 44 ARKANSAS LAWYER 10, 12 (Spring, 2009).
  - a. The statutory law of correlative rights, as previously noted, focuses primarily on ensuring that an equitable opportunity is provided each oil and gas owner to develop their portion of the resource.
  - b. This is also demonstrated by the drilling unit statutes which require that interests within a drilling unit be integrated “upon terms and conditions which are just and reasonable and which will afford the owner of each tract or interest in the drilling unit the opportunity to recover or receive his or her just and equitable share of the oil and gas in the pool without unnecessary expense and will prevent or minimize reasonably avoidable drainage from each developed unit which is not equalized by counter drainage.” ARK. CODE ANN. § 15-72-304 (2009).
5. One commentator has suggested that Arkansas would likely recognize a limitation on the rule of capture similar to that imposed by the Texas Supreme Court in *Elliff v. Texon Drilling Co.*, 210 S.W.2d 558 (Tex. 1948).

Susan Webber Wright, *The Arkansas Law of Oil and Gas*, 9 U. OF ARK. AT LITTLE ROCK L.J. 223, 234-35 (1987).

- a. Any act by an owner that impairs the ability of other owners in the reservoir to exercise their capture rights would be a violation of their correlative rights.
- b. This analysis is supported by the court's observations in *Young v. Ethyl Corporation*, 521 F.2d 771 (8<sup>th</sup> Cir. 1975), *cert. denied*, 439 U.S. 1089 (1979), where it noted the rule of capture would be constrained by "the doctrine of 'correlative rights.'" *Id.* at 774.

## **B. Brine**

1. The "brine cases" demonstrate a reluctance by courts to grant any one party in a reservoir an undue advantage because of the connected nature of the reservoir.
2. If courts give the hold-out a trespass claim, the hold-out receives undue power over the operator desiring to invest in secondary and other enhanced recovery techniques that require use of the reservoir.
  - a. The trespass remedy does much more than merely protect the owner's land; it effectively impedes use of the entire reservoir.
  - b. When dealing with a connected reservoir any trespass remedy will have considerable extra-territorial impact.
3. If courts give the operator the benefits of the rule of capture to deal with the hold-out, the operator receives undue power over the hold-out and may elect to simply ignore them.
4. The court in *Young v. Ethyl Corporation*, 521 F.2d 771 (8<sup>th</sup> Cir. 1975), *cert. den.* 439 U.S. 1089 (1979), opined that if it adopted a capture remedy (which it rejected), the operator would nevertheless be subject to "the doctrine of 'correlative rights.'" *Id.* at 774.
  - a. The court, however, limited the doctrine to a duty not to "injure the source of supply" or to "take an undue proportion of the oil and gas from the common pool." *Id.* at 775.
  - b. The court focused on the "undue proportion" language suggesting that allowing the rule of capture to operate in this situation would, in any event, violate correlative rights by allowing the operator to take an undue proportion of the brine.
5. The balance between trespass and the rule of capture was ultimately struck in *Jameson v. Ethyl Corporation*, 609 S.W.2d 346 (Ark. 1980).
  - a. The court allowed the otherwise trespassing activity to take place so long as "such operations are carried out in good faith for the purpose of maximizing recovery from a common pool." *Id.* at 351.

- b. However, the extracting party must “compensate the owner of the depleted lands for the minerals extracted in excess of natural depletion, if any, at the time of taking and for any special damages which may have been caused to the depleted property.” *Id.*
- c. The “good faith” aspect of the rule was explored by the court in *Deltic Timber Corporation v. Great Lakes Chemical Corporation*, 2 Fed. Supp.2d 1192 (W.D. Ark. 1998). This court also revisits the scope of the capture analysis applied in *Budd v. Ethyl Corporation*, 474 S.W.2d 411 (Ark. 1971).

### C. Water

- 1. *Harris v. Brooks*, 283 S.W.2d 129 (Ark. 1955) (adopting reasonable use theory as applied to surface waters).
  - a. “The use of the stream or water by each proprietor is . . . limited to what is reasonable, having due regard for the rights of others above, below, or on the opposite shore.” *Id.* at 133.
  - b. The rights of the riparian owner are “qualified only by the correlative rights of other riparian owners, and by certain rights of the public, and they are to be so exercised as not to injure others in the enjoyment of their rights.” *Id.*
- 2. *Jones v. Oz-Ark-Val Poultry Company*, 306 S.W.2d 111 (Ark. 1957) (adopting reasonable use theory as applied to subsurface waters).
  - a. “[T]he right of a landowner to appropriate percolating water in his own land is limited by the corresponding right of his neighbor, and extends only to a reasonable exercise of such right; or, as said by the court, the rights are correlative.” *Id.* at 114.
  - b. “Where two or more persons own different tracts of land, underlaid by porous material extending to and communicating with them all, which is saturated with water moving with more or less freedom therein, each has a common and correlative right to the use of this water . . . .”

## V. NEW ROLE FOR CORRELATIVE RIGHTS ANALYSIS: CROSS-BOUNDARY INTRA-RESERVOIR DISPUTES

### A. Cross-Boundary Fissures Caused by Hydraulic Fracturing

- 1. *Coastal Oil & Gas Corporation v. Garza Energy Trust*, 268 S.W.3d 1 (Tex. 2008) (forms of action and the rule of capture used to avoid addressing whether sending a frac fissure across a boundary line is a trespass).
- 2. *Stone v. Chesapeake Appalachia, LLC*, No. 5:12-cv-102, 2013 WL 2098397 (N.D. W.Va. April 10, 2013), *vacated* 2013 WL 7863861 (N.D. W.Va. July 30, 2013) (sending a frac fissure across a boundary line is a trespass).



**B. Horizontal Drilling into Conventional Formations with Existing Vertical Wells**

1. This is highlighted by the “frack-hits” issue.
2. How should real or potential geophysical communication between wells during hydraulic fracturing be addressed?
3. What are the correlative rights of the various well owners within a reservoir?

**C. Secondary and Enhanced Recovery Operations: A Second Look?**

1. This is the same rights of the “old” vs. rights of the “new” issue noted in item B above.
2. To what extent can I be the “stick-in-the-mud” and hold up operations?

**D. Waste Injection**

1. I own 10 acres, an injection well, and a UIC permit.
2. Waste migration and trespass.

**VI. CORRECTLY DEFINING PROPERTY RIGHTS IN THE RESERVOIR**

**A. Reservoir Property Principles**

1. “Trespass” is not the correct concept for application to property that is intricately connected and only artificially divided by a boundary line.
2. To determine whether the tort of trespass is possible, you must first properly define the property rights of the parties involved.
3. “Property” in a reservoir includes rights that extend beyond boundary lines.

**B. Reservoir Community Analysis**

1. Each reservoir owner has rights and obligations as a member of the reservoir community.
  - a. This is the one area where boundary lines play an important role.
  - b. Boundary lines are referenced to determine if you are physically within the community and therefore a member.
2. Community membership both expands and contracts the rights of each member.
3. Activity within the reservoir is judged by what is good for the reservoir community.
4. For example, in the *Coastal* case the inquiry should have been: is the proposed activity (hydraulic fracturing) good for the Vicksburg T Formation community?