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INTRODUCTION

"Conservation," by Webster's definition, means "a conserving, preserving, guarding or protecting" But as applied to oil and gas, our irreplacable natural resource, it also means "the production of oil or gas from any pool or by any well in accordance with methods designed to result in maximum ultimate recovery."[1] This was the language used by the 1953 Montana Legislature when it enacted the important new Oil and Gas Conservation Commission Law.[2] This law, which became effective April 1st, 1953, establishes a system for the regulation of the oil and gas industry which is designed "to prevent waste" by obtaining the greatest and most economic recovery of Montana's petroleum resources.

The production of oil is a major industry in Montana. Since the first discovery of oil in commercial quantities in this state, almost $400,000,000[3] of oil has been produced. Approximately 45,000 barrels of oil are now being produced per day from Montana's 43 oil and gas fields and this daily production rate is steadily increasing. Surely it follows that anything that is good for this growing industry is good for the State of Montana. The chief theorem of effective conservation legislation and regulation in the public interest for the prevention of waste lies with this matter of securing the greatest ultimate recovery of oil an gas.

Before reviewing Montana's presently effective conservation statutes and administrative rules and regulations, it might be helpful to discuss some of the historical aspects of Montana's oil and gas conservation legislation and regulatory practices.

Montana Conservation Prior to April 1, 1953

Oil was first discovered in Montana in commercial quantities in 1915. This discovery was made in the Elk Basin field, which straddles the Montana-Wyoming boundary. There followed discoveries in the Devil's Basin field in 1919, the Cat Creek field in 1920, Soap Creek field in 1921, Kevin-Sunburst in 1922, and the Cut Bank field in 1932. From that time—1932—until the first discovery in the Montana portion of the Wiliston Basin—a period of approximately 20 years—Montana did not see the discovery of a new major oil field, although new pools were found on known structures in consequence of deeper drilling. At the time of the first Williston Basin discovery, it can be said that Montana had only three fields of national importance—Elk Basin, Kevin-Sunburst and Cut Bank. July of 1951—when Shell Oil Co. made its Richey discovery in Dawson County—opened the Montana chapter of the Williston Basin story and the numerous discoveries since that date are too well known to warrant repetition here.

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[1]Laws of Montana 1953, c. 238, § 3A (4).

[2]Laws of Montana 1953, c. 238.

[3]CONSERVATION COMMISSION OF MONTANA, STATEMENT OF CRUDE OIL PRODUCTION AND VALUATION, ALL MONTANA FIELDS, ACCUMULATED TOTALS FROM DISCOVERY DATE.

The first oil and gas regulatory legislation enacted in Montana was in 1917[4]—two years following the first commercial discovery. This legislation required an operator to case a well to prevent surface or fresh water from penetrating oil and gas formations and to exclude salt water from intruding oil and gas strata. It also provided for the plugging of wells. Then, in 1921,[5] the legislature delegated to the Board of Railroad Commissioners authority to make rules and regulations to prevent waste of oil and regulate field operations dangerous to life or property. Finally, in 1933,[6] the legislature created an Oil Conservation Board which was to have concurrent jurisdiction with the Board of Railroad Commissioners. Probably the impelling reason for the enactment of this legislation was the fear that lack of a satisfactory oil conservation law would expose the industry in this state to regulation by agencies of the National Industrial Recovery Administration. That legislation, with only minor changes, was effective in Montana for twenty years or until the effective date of our new conservation law on April 1st of 1953.

During this twenty-year period these two administrative agencies—the Board of Railroad Commissioners and the Oil Conservation Board—exercised joint regulatory power and enforcement of our conservation statutes. The Board of Railroad Commissioners assumed the responsibility of supervising the drilling, abandonment and plugging of oil and gas wells. The duties of the Oil Conservation Board were in the nature of general control with relation to production, storage and transportation of oil. The principal functions performed, however, were with regard to the filing of reports by crude producers, transporters and refiners and the dissemination of this information to the industry and other interested parties. The statutory law then effective did not permit adequate enforcement of modern conservation practices. For example, it contained no definition of waste, and no specific provisions for preservation of reservoir energy, maintenance of water-oil and gas-oil ratios, ratable taking of gas, and other matters. Overlapping of duty and, perhaps, a certain amount of inefficiency resulted from the delegation of regulatory authority to these two separate agencies.

Our conservation laws then effective did authorize these two agencies to promulgate and administer rules and regulations. The Board of Railroad Commissioners adopted a set of Operating Regulations. The law required that these rules and regulations should be the same as those prescribed by the U. S. Geological Survey and these were so adopted and constituted the regulatory control of drilling, abandonment and plugging of oil and gas wells. The Oil Conservation Board also adopted regulations but these had only to do with the filing of reports of producers, transporters, storers and refiners of oil. During this period, one public hearing was held by the Oil Conservation Board. Neither the Montana Supreme Court nor the state inferior courts were called upon to determine the validity or interpret these adopted rules and regulations or our conservation laws as then effective.

[4]Laws of Montana 1917, c. 43; REV. CODES OF MONTANA §§ 3547-3549 (1921), repealed by c. 56 Laws of Montana 1925; REV. CODES OF MONTANA §§ 3552.1-3552.4 (1935).

[5]Laws of Montana Ex. Sess. 1921, c. 8; REV. CODES OF MONTANA §§ 3552.1-3552.4 (1935).

[6]Laws of Montana Ex. Sess. 1933, c. 18; REV. CODES OF MONTANA §§ 3554.1-3554.19 (1935).

It was felt by many that Montana's conservation legislation and regulatory practice prior to discoveries in the Williston Basin were adequate to accomplish their purpose. There were but few complaints of wastage and this probably because the then most prolific pools were of a "low pressure" type with respect to natural oil-gas production ratios and operators were not confronted with difficult production problems involving waste. Those with foresight knew, however, that our conservation laws then operative would be unsatisfactory if there followed materially increased production from deeper pools. Initial experience in the Williston Basin confirmed this prediction and provided the impetus which resulted in the 1953 Oil and Gas Conservation Law being enacted by the Montana Legislative Assembly.

The Montana Oil and Gas Conservation Law

Writing in 1948, Mr. E. K. Cheadle, one of the state's outstanding authorities on the conservation of oil and gas, had this to say:

> Today's satisfactory conservation practices have discouraged wasteful exploitation of Montana's resources, and have contributed to the financial prosperity of land owners, operators and state educational institutions. Conservation accomplishments in Montana have been comparatively good; extant statutory law, ostensibly adequate, is deficient. The state conservation program would be strengthened by modification of the statutes to provide: (1) delegation of regulatory power to one agency having no over-lapping concurrent powers and duties; (2) a definition of waste; (3) provisions and enumerations of exact practices to prevent waste and promote conservation; and (4) adequate funds for regulation.

It was with these objectives in mind that our legislature approached the task of formulating a new body of oil and gas conservation legislation. The result was the introduction of Senate Bill 55 which after careful attention, became law and effective on April 1, 1953, as the Oil and Gas Conservation Commission Law, Chapter 238, Session Laws of Montana, 1953. The source of this new law, in the main, is the model legislation for an oil and gas conservation statute promulgated by the Interstate Oil Compact Commission.[7] It is, however, essentially a waste preventive measure and does not, specifically, contain those provisions contained in this model law relating to the protection of correlative rights nor market demand proration.

Permit me to review briefly for you the main provisions of this law.

(1) It creates a Commission of five persons, appointed by the Governor, two of whom are industry members and three of whom are lay members.[8] All regulatory authority is vested in this Commission and authority formerly delegated to the Board of Railroad Commissioners is removed and the former Oil Conservation Board is abolished.[9]

(2) A definition of "waste" appears in our conservation law for the first time.[10] This definition is identical with that appearing in model legis-

[7]LEGAL COMMITTEE, THE INTERSTATE OIL COMPACT COMMISSION, OKLAHOMA CITY, OKLAHOMA, A FORM FOR AN OIL AND GAS CONSERVATION STATUTE (adopted September 1, 1949, amended May 4, 1950).

[8]Laws of Montana 1953, c. 238, § 2(b).

[9]Laws of Montana 1953, c. 238, § 15.

lation and many of the oil producing states, except that subdivision (5) providing,

> 'Waste' means and includes . . . (5) the production of oil or gas in excess of transportation or marketing facilities or in excess of reasonable market demand,

is omitted, and in its place there is this statutory language,

> . . . ; provided, however, that the production of oil or gas from any pool or by any well to the full extent that such well or pool can be produced in accordance with methods designed to result in maximum ultimate recovery, as shall be determined by the Commission, shall not be deemed to be waste within the meaning of this definition.[11]

There follows authority[12] granted the Commission and, also, an imposition of a mandatory duty to make investigations to determine whether waste exists or is imminent, together with further enumeration of what practices —for example, the drilling, producing and plugging of wells—shall be regulated to prevent waste.

(3) A third principal provision[13] grants the Commission authority to establish well spacing units for a pool in order to prevent or to assist in preventing waste of oil or gas. The substantive issues which will arise in establishing these units, and the procedural methods of establishing them, are clearly set forth in the law.

(4) Commission procedure, administrative remedies of interested parties and judicial remedies and right of appeal necessary to effectuate the purposes of the act are fully set forth.[14]

(5) Necessary provisions relating to lands over which the Commission has jurisdiction[15] (all lands in the state subject to the state's police and taxation powers but with certain exceptions as to lands of the United States), drilling bonds,[16] filing of report forms,[17] authorization of unit agreements or developments,[18] and other miscellaneous provisions are included.

(6) A license and privilege tax of ¼¢ per barrel on wells producing an average of less than 25 barrels per day, ½¢ on those over 25 barrels, of 1 mill per 10,000 cubic feet of natural gas and a graduated drilling permit fee are imposed for the purpose of providing funds for defraying the expenses of the Commission.[19]

Adopted Rules and Regulations

Following the Commission's creation on April 1st, 1953, first efforts were directed to organizational matters and the adoption of rules and regulations under which the oil and gas industry would operate in the State of

[10] *Id.* § 3(a).
[11] *Id.* § 3(a) (4).
[12] *Id.* § 4(c).
[13] Id. § 6.
[14] *Id.* §§ 11, 12.
[15] *Id.* § 17.
[16] *Id.* § 4(c) (1) (d).
[17] *Id.* § 4(c) (1) (b).
[18] *Id.* § 8.
[19] *Id.* § 22.

Montana. This duty was imposed by law[20] upon the Commission, and after fourteen hearings and scheduled meetings throughout the State with representatives of the oil and gas industry and other interested parties, a comprehensive set of general rules and regulations were adopted to govern operations in the State.

The 1953 Law also required[21] the Commission to adopt rules and regulations governing the practice and procedure before the Commission and these rules of practice and procedure were so adopted.

It was the Commission's intent that this comprehensive operating code for the oil and gas industry would constitute general rules and regulations and be of statewide application. It was anticipated that special rules and regulations or field rules would thereafter be adopted for Montana's oil and gas fields, in order to conform with specific requirements in these individual fields, such as the spacing of wells, operating practices, etc.

Accordingly, following the adoption[22] of general rules and regulations, the Commission instituted a series of hearings to consider the adoption, and did adopt, special field rules for the individual fields in the state.

Let me review briefly for you the form followed in the preparation of these rules and some of the more important rules.

These rules are divided into four main sections.

General. This section contains a series of fifty-four definitions of terms which are used in the general rules, appear in the law, or will, perhaps, be utilized in the adoption of special rules. As I mentioned, the basic plan of these general rules is that special field rules will be adopted from time to time and that these—the special field rules—will prevail as against general rules if in conflict therewith. This plan recognizes that spacing, operating and production procedures will vary in the oil and gas fields throughout the state. To date, the Commission has held 11 field hearings and special field rule orders have been adopted pertinent to these fields. In the main these special field rules have concerned spacing, *i.e.*, the adoption of a special spacing rule different than the statewide spacing rule for that field.

This section—the General Section—also sets out the chief personnel of the Commission. The Commissioners serve on a per diem basis and usually meet once or twice per month for regular meetings and hearings. The regular business of the Commission is carried out by the Executive Secretary, who is the chief administrative officer, and the Petroleum Engineer, who, with the assistance of a field office and personnel in Billings and Shelby carry out the operations and enforcement of the Act and the rules and regulations.

Drilling, Development, Producing and Abandonment. This is the important section of the general rules and constitutes a comprehensive operating code. Here is spelled out the procedures to be followed in commencing, conducting and discontinuing oil and gas activities in the state.

Rule 201 sets forth the requirement of filing a Notice of Intention to drill, securing approval and obtaining a permit to drill from the Commission.

[20] *Id.* § 4(c) (5).
[21] *Id.* § 9(a).
[22] OIL AND GAS CONSERVATION COMMISSION OF MONTANA, Order No. 1-1 (November 30, 1953).

Prior to the granting of a permit, however, the Commission will require a surety bond from the operator conditioned for performance of his duty to properly plug the hole if dry or abandoned. This regulation offers a choice of separate bonds and blanket bonds. A break-level of 3,500 feet is adopted and a single bond of $2,500 or blanket bond of $5,000—if more than one well is to be drilled—are set for these shallow depths. For depths in excess of 3,500 feet, these bond amounts are doubled, *i.e.*, $5,000 and $10,000 for a blanket bond.

Rule 203 is the important statewide spacing rule. This provides that no wildcat well shall be drilled less than 330 feet from any lease or property line. Development wells shall not be drilled less than 330 nor less than 990 feet from any other drilling or producible well. Gas wells are not to be drilled less than 1320 feet from any lease or property line, nor less than 1320 feet from any other drilling or producible well.

This matter of spacing has received considerable attention from the Commission, operators and other parties interested in oil and gas development. This paper would be incomplete without further discussion of this important subject.

"Spacing" is referred to in the Montana statute first in the definition of "waste" wherein it is provided that—

> 'Waste' means and includes . . . (3) the *location, spacing* . . . of any oil or gas well or wells in a manner which causes, or tends to cause, reduction in the quantity of oil or gas ultimately recoverable from a pool . . . . (Italics added.)

Section 4.C.[23] then provides, in part, as follows:

> The commission has authority, *and it is its duty*: . . . (2) For the purpose of preventing waste, (a) to regulate . . . the spacing of wells . . . . (Italics added.)

In the third reference to this matter of spacing, Section 6[24] authorizes the Commission to establish well spacing units for a pool.

In the adoption of rules and regulations relating to spacing, these statutory provisions were interpreted to mean that, first, the Commission was under a mandatory duty to regulate the spacing of wells, and, secondly, the Commission had authority, in its discretion, to establish spacing or drilling units. In compliance with that duty, Regulation 203—the statewide spacing rule—was adopted. No regulations were adopted pertinent to the establishment of spacing units since the statute (Section 6) is complete as to the procedural and substantive aspects of establishing such drilling units.

I review the background of this spacing matter for you because the interpretation of the Commission—particularly with regard to the authority of the Commission to adopt a statewide spacing rule—has been opposed. The Attorney General has filed a brief in opposition to this rule contending that a statewide spacing rule would be unworkable in many pools, if rigidly adhered to would cause, not prevent, waste and would be an interference with the land owner's free use of his own land and achieve no compensating advantage for him or for the state. Certain operators have also opposed

[23]Laws of Montana 1953, c. 238.
[24]Laws of Montana 1953, c. 238.

the Commission's position and their objections, as well as the brief of the Attorney General, are available for study among the records of the Commission.

The statewide spacing rule as it has been discussed here is presently effective and its validity or invalidity has not been, nor is it being, considered at this date by any Montana court.

The other operating rules set out in this section of the general rules concern actual operating procedures which are to be followed. For example, rotary and cable drilling procedures, necessity for chokes, fire walls, dual completion of wells, required tests, plugging methods and procedures to be followed, etc.

Rules of Practice and Procedure. Section 300 sets down the rules to govern the commencement and conduct of proceedings before the Commission.

The keynote of this series of rules is that while hearings are to be conducted without rigid formality, certain ground rules are desirable and necessary in order to maintain orderly hearings and to expedite matters before the Commission. Matters may be initiated by the Commission or by the petition of any interested person. The term, "interested person," is, incidentally, required by the statute to be interpreted "broadly and liberally."[25] When a proceeding is instituted it is docketed and notice of hearing issues. A hearing may be continued from time to time (but not to exceed 180 days). Following adjournment, the Commission must adopt its order within thirty days. Thereafter, a further administrative remedy is available to any person adversely affected by the order who may, within 20 days, apply for a rehearing.

Miscellaneous. Section 400 is designated a Miscellaneous section. The most important rule here is the rule (401) integrating the 13 forms which are referred to in prior rules and the official adoption of these forms.

Review of Commision Action; Conclusion

Montana has now completed the formative state of its newly-established conservation program and has just begun what might be termed its operative period. This first phase was concerned with the drafting and passage of a new modern conservation statute, organization of this new administrative tribunal and adoption of the working tools to supplement this new law —the rules and regulations.

To date the Commission has adopted 47 orders. These classify into three groups. The majority are special field rule orders, *i.e.*, spacing rules and operating rules peculiar to the individual fields. The second large group constitute orders permitting special exceptions to spacing rules. These are cases wherein the operator has desired to drill but has been unable to conform to the established rules. He then petitions the Commission for a special exception and, after notice and hearing, if satisfactory evidence of need is submitted the exception has been granted. Other orders adopted have concerned the approval of water flood projects, minor changes in the adopted forms of the Commission, etc.

[25]Laws of Montana 1953, c. 238, § 12.

One order of particular importance I want to call to your attention is the East Poplar field rule order.[26] This is a special field rule order covering many of the operational matters usually covered in these orders. In addition, however, and the significance of the order is that this is the first order in which the Commission has established a maximum efficient rate of production. After three hearings, 472 pages of transcript, the Commission made findings of fact that waste existed in certain competitive areas of the field by undue dissipation of reservoir energy. Accordingly, a maximum efficient rate of production of 150 barrels of oil per day was set for certain competitive areas. It is interesting to note that pressure tests were run again on these wells this past week and these indicate that the pressure decline per barrel produced has decreased, is stabilizing, and the per cent of water cut has dropped off. The fulcrum of effective oil and gas conservation regulation in the public interest for the prevention of waste lies with this matter of the preservation and proper utilization of this natural reservoir energy which is necessary to secure the greatest ultimate recovery of oil and gas. In my opinion, the Montana Oil and Gas Conservation Commission is to be commended in the manner it has handled and the results it has obtained in the East Poplar Field—conservation has been and is being effected.

There has been, to date, no judicial review, either by our District Courts or Supreme Court, of any Commission order or any interpretation of any provision of the Conservation Act. Two cases have been commenced against the Commission but both were dismissed without a decision on the merits.

In conclusion, true conservation has emerged from a beginning of gross ignorance to an era of known and established principles applied to discovery, development and operation of oil and gas reservoirs to prevent waste in the public interest. Our present law and regulations are, I believe, well-suited for this purpose and will, so long as they are fairly and competently interpreted and administered, obtain the maximum recovery of this irreplacable natural resource.

[26] OIL AND GAS CONSERVATION COMMISSION OF MONTANA, Order No. 7-55 (March 7, 1955).