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Some Legal Aspects of the Unitization of Federal, State and Fee Lands

CLARENCE E. HINKLE*

Before discussing some of the legal aspects of the unitization of oil and gas fields, I would like briefly to call your attention to the importance of unitization, especially in the Public Land States. Unitization is already laying a major role in the oil development of most of the States which have members of the Bar participating in this sectional meeting of the American Bar Association. Four of the six States having representatives participating in this meeting are oil and gas producing States, namely Colorado, Montana, Utah, and Wyoming, and there is apparently considerable prospecting for oil and gas in Idaho and Oregon. All of these States contain great bodies of Federal and State land.

According to the records in the office of the United States Geological Survey, Washington, D.C., as of April 1, 1952, the following unit agreements embracing Federal lands had been approved: In the State of Colorado, 38 units, aggregating 588,041 acres, of which 18 were still in effect containing 268,297 acres. Although there is apparently no record of oil production in the State of Idaho, three unit agreements had been approved embracing 59,437 acres. In the State of Montana, 24 unit agreements embracing 686,916 acres, of which 14 were outstanding as of that date containing 374,116 acres. In the State of Utah, 54 units, embracing 1,416,120 acres, of which 28 were outstanding as of that date, containing 709,662 acres. In the State of Wyoming, 204 units embracing 2,450,343 acres, of which 99 were outstanding containing 1,058,896 acres. There have been more unit agreements approved containing Federal lands in the State of Wyoming than in any other State. In fact, up to April 1, 1952, 48% of all Federal unit agreements were located in the State of Wyoming.

Up to April 1, 1952, there had been 425 unit or cooperative plans approved covering Federal lands in the various States embracing some 6,702,701 acres, of which 214 were still outstanding as of that date containing 3,348,619 acres.

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It is also interesting to note that the total royalty income to the United States on account of the production of oil and gas from Federal lands during the calendar year ending December 31, 1951, amounted to \$27,544,266, of which \$12,647,548, or 45.92% was derived from oil and gas produced under approved unit plans.¹

Unitization was practically unknown before 1930 and, consequently, is a subject which has been almost wholly developed since that time. Unitization has been referred to as "the practice of consolidating or integrating the ownership or control of an actual or prospective oil or gas pool or area by combining all titles or interests so that it may be explored, developed, and operated as one property for the benefit of all parties concerned."² Unitization in theory and practice is probably the best method yet devised to operate an oil and gas field to obtain the maximum recovery with a minimum of waste. Unit operation makes possible:

- (1) Orderly development;
- (2) The use of the most efficient well spacing pattern;
- (3) The elimination of the drilling of unnecessary wells and thus the reduction of economic waste;
- (4) The conservation of reservoir energy; and
- (5) The initiation and operation of efficient secondary recovery programs.

In the Western Public Land States, it is necessary, in most instances, in formulating a unit plan of operation to deal with three classes of land: viz. Federal, State and fee, or privately owned lands. Because of the fact that the United States is the largest land owner in most of the Western Public Land States, most units have been formed as a result, either directly or indirectly, of the provisions of the Federal Mineral Leasing Act providing for unitization and the regulations promulgated pursuant thereto. In fact, the Department of the Interior has been the foremost advocate of unitization and most unit plans have revolved around the Federal laws and regulations rather than the laws and regulations of any particular State. So far as I have been able to determine, there are thirteen States which have specific statutory provisions pertaining to unitization. Most of these laws authorize the State officials charged with the leasing

¹All of the preceding factual data with respect to the approval of Federal unit agreements and the royalty income to the United States were obtained through the courtesy of H. J. Duncan, Chief, Conservation Division, United States Geological Survey, Washington, D.C.

²June 1943 issue of the Texas Law Review, "Some Legal and Economic Aspects of Unit Operations of Oil Fields."

LEGAL ASPECTS OF UNITIZATION

51

of State lands to consent to or approve unit agreements involving Federal lands. These States are Arizona, California, Colorado, Idaho, Illinois, Louisiana, Montana, Nebraska, New Mexico, South Dakota, Utah, Washington, and Wyoming. None of these States seem to have advocated any particular form of unit agreement. However, some of the States have worked out changes in the Federal form which are acceptable both to the United States Geological Survey and the State officials.*

Time will not permit me to go into much detail as to the history of unitization. However, I would like to point out some of the facts and circumstances surrounding the amendments to the Federal Mineral Leasing Act approved by the Congress February 25, 1920, which make up, to a great extent, the history of unitization.*

On July 3, 1930, the Congress amended Section 17 of the Federal Mineral Leasing Act⁵ to provide for the unitization of permits and leases embracing Federal lands, which was the first amendment authorizing unitization. This was a temporary act which expired at midnight on the 31st day of January 1931, and it appears to have been passed mainly for the purpose of permitting the Secretary of the Interior to approve a unit plan of operation for the North Dome of the Kettleman Hills Field.⁶ Previous to this, in March 1929, President Hoover and Ray Lyman Wilbur, then Secretary of the Interior, had withdrawn the

- *Arizona : Chapter 87, Laws of 1939.
- California : Chapter 584, 1941 Stats.
- Colorado : Laws of 1947, page 692, Sec. 1.
- Idaho : Chapter 120, Laws of 1949.
- Illinois : Chapter 104, Smith-Hurd Illinois Revised Stats., approved July 18, 1941.
- Louisiana : Louisiana Rev. Stats. of 1950, Title 30, Sec. 129.
- Montana : Chapter 128, Laws of 1945.
- Nebraska : Chapter 163, Laws of 1943.
- New Mexico : Chapter 88, Laws of 1943, as amended by Chapter 162, Laws of 1951.
- South Dakota : Chapter 196, Laws of 1939.
- Utah : Chapter 127, Laws of 1945, and Chapter 129, Laws of 1947.
- Washington : Chapter 161, Laws of 1937.
- Wyoming : Chapter 17, Laws of 1945.
- "An Act to Promote the Mining of Coal, Phosphate, Oil, Oil Shale, Gas and Sodium on the Public Domain" (41 Stat. 437).
- ⁶Amendment to Federal Mineral Leasing Act, approved July 3, 1930 (46 Stat. 1007).
- William L. Holloway, in his very interesting paper : "Unit Operation of Public Lands," presented before the Third Annual Institute on the Law of Oil and Gas and Taxation, Southwestern Legal Foundation at Dallas, Texas, in January 1952, states that the only two units approved under the temporary Act of July 3, 1930, were the units for the "North Dome of Kettleman Hills" and for "Little Buffalo Basin Gas Field", Wyoming.

Federal Public Domain from leasing due to the near chaos in the oil industry resulting from overproduction. After many contests and much litigation, the right of withdrawal was sustained by the United States Supreme Court.⁷ On March 4, 1931, Section 17 of the Federal Mineral Leasing Act was again amended,⁸ to provide in effect that any twenty year lease embracing Federal land committed to a cooperative or unit plan of development or operation would be continued in effect beyond its twenty year term until the termination of the plan, and that the Secretary should report all leases so continued to Congress at the beginning of its next regular session after the date of such continuance. This amendment also provided that any cooperative or unit plan of development or operation which included lands of the United States should "contain a provision whereby authority, limited as therein provided, is vested in the Secretary of the Department or Departments having jurisdiction over such land to alter or modify from time to time in his discretion the quantity and rate of production under said plan." At the same time Section 27 of the Leasing Act was also amended to provide: "That for the purpose of more properly conserving the natural resources of any single oil or gas pool or field, permittees and lessees thereof and their representatives may unite with each other or jointly or separately with others in collectively adopting and operating under a cooperative or unit plan of development or operation of said pool or field, whenever determined and certified by the Secretary of the Interior to be necessary or advisable in the public interest. . . ." The Secretary was also authorized in his discretion and with the consent of the owners of leases and permits involved "to establish, alter, change or revoke drilling, producing, and royalty requirements of such leases or permits, and to make such regulations with reference to such leases and permits", in connection with the institution and operation of cooperative or unit plans. The amendment also authorized the Secretary to approve operating, drilling or development contracts made by one or more permittees or lessees of oil and gas leases or permits with one or more persons, associations or corporations, regardless of the acreage limitations provided for in the Act, where such agreement was for the purpose of conserving the natural products or the public convenience or the interests of the United States would be best subserved thereby.

⁷United States of America, ex rel Ethel M. McLennan, Petitioner, v. Ray Lyman Wilbur, Secretary of the Interior, 283 U.S. 414; 75 L.ed. 1148.

⁸Amendment to Federal Mineral Leasing Act, approved March 4, 1931 (46 Stat. 1523).

LEGAL ASPECTS OF UNITIZATION

53

On April 4, 1932, Secretary Wilbur again opened the Federal Public Domain to prospecting permits for oil and gas.⁹ In submitting new regulations to the Commissioner of the General Land Office, Secretary Wilbur stated: "In general, the attached regulations require that certain stipulations accompany any application for a prospecting permit. These stipulations do not impair the permittee's privilege to drill immediately, if he so desires, but do require that prior to the expiration date of the permit a cooperative development plan for the entire structure be submitted, and that when and if production is obtained, the area be produced under a unit plan of operation which, under the direction of the permittees, themselves, and under the general supervision of the Secretary of the Interior, will insure a ratable share of production to all of them on the same structure, and, at the same time, insure against overproduction and consequent waste."¹⁰

The new regulations required the permittee to submit to the Secretary of the Interior for his approval within two years from the date of the permit an acceptable plan for the prospecting and development as a unit of the pool or field affecting the permitted lands, and further provided that the applicant should agree that no oil or gas in commercial quantities would be produced except pursuant to a plan of unit operation approved by the Secretary.¹¹ Thus, the Secretary of the Interior made it compulsory that all Federal lands be developed and that oil and gas be produced therefrom under a cooperative or unit plan of operation approved by the Secretary. The Congress had authorized from time to time the extension of existing permits, and after the issuance of these regulations no permit was to be extended unless the permittee submitted an acceptable cooperative or unit plan of development and operation. This system of compulsory unitization was doomed to failure from the start. Apparently no thought or consideration had been given to the fact that it would be necessary, in most instances, to consider lands other than Federal lands in connection with any cooperative or unit plan which attempted to embrace an entire geological structure or feature which would necessarily have to be the subjects of the plan. In many instances,

⁹The issuance of permits was suspended from March 13, 1929, to April 4, 1932, at which time the Secretary issued new regulations pertaining to the issuance of permits.

¹⁰Instructions issued by Secretary Wilbur to the Commissioner of the General Land Office on April 4, 1932.

¹¹Regulations of Secretary Wilbur approved April 4, 1932, providing for the issuance of permits subject to unitization. (Vol. 53, Decisions of the Department of the Interior, page 641.)

Federal permits covered non-contiguous tracts interspersed with State and fee lands; then, too, thousands of the permits were in the hands of individuals who were not actually engaged in the oil and gas business. As a result of the regulation hundreds of unit plans were submitted to the Department without any foundation in fact to show that the lands involved were properly the subject of unitization. Only five or six unit agreements were actually approved.¹² And, in fact, the Department became so swamped with unit plans submitted in connection with the extensions of time that many were never considered and the permits extended simply ostensibly due to the diligence and ingenuity of the permittee in endeavoring to comply with an unworkable regulation. It was not many months after the issuance of the regulation before most of the officials in the Department of the Interior charged with the administration of the Leasing Act began to realize that the regulation was wholly impracticable and that it was impossible, because of varying circumstances and conditions, to unitize all Federal lands.

On August 21, 1935, the Congress again amended the Federal Mineral Leasing Act,¹³ and, in so doing, virtually did away with the old permit system which was established under the original Act by providing for the issuance of oil and gas leases and the exchange of existing permits for leases upon a more nearly commercial form providing for a royalty to the United States of not less than 12½% and, in most cases, for a term of five years and as long thereafter as oil or gas in paying quantities should be produced from the leased premises. This amendment was the first to clearly provide for compulsory unitization, by giving authority to the Secretary to require Federal leases to be conditioned upon an agreement by the lessee "to operate, under such reasonable cooperative or unit plan for the development and operation. . . ." of the field or pool as the "Secretary may determine to be practicable and necessary or advisable. . . ."

On August 8, 1946, the Congress again amended the Mineral Leasing Act¹⁴ and liberalized the acreage limitations to provide that any one person, association or corporation could hold oil and gas leases in any one State aggregating 15,360 acres, and, in addition, non-renewable options for a period of two years when taken for the purpose of performing geological or geophysical ex-

¹²"Unit Operation Agreement on Public Lands," by Holland and Hines.

¹³Amendment to Federal Mineral Leasing Act approved August 21, 1935 (49 Stat. 674).

¹⁴Amendment to Federal Mineral Leasing Act approved August 8, 1946 (Public Law 696, 79th Congress; 60 Stat. 950-952); 30 U.S.C. Par 226 (1948).

LEGAL ASPECTS OF UNITIZATION

55

ploration on not to exceed 100,000 acres in any one State, and to provide in most cases as to future discoveries for a flat royalty to the United States of 12½%. Prior to that time one person, association or corporation had been limited to 7,680 acres in any one State and the minimum royalty to the United States was 12½%. At the same time, Section 17 of the Act was again amended to more explicitly provide for the unitization of Federal lands. This amendment provides that the owners of Federal leases may unite with each other or jointly or separately with others in collectively adopting and operating under a cooperative or unit plan of development for the purpose of more properly conserving the natural resources of any oil or gas pool, field, or area whenever determined and certified by the Secretary of the Interior to be necessary or advisable in the public interest. The 1935 Act was amended by the 1946 Act to give the Secretary authority "in his discretion" to establish, alter, change, or revoke drilling, producing, rental and royalty requirements.

The 1946 Amendment also provides that any cooperative or unit plan which includes lands of the United States "may in the discretion of the Secretary contain a provision whereby authority is vested in the Secretary of the Interior, or any such person, committee, or State or Federal officer or agency as may be designated in the plan, to alter or modify from time to time the rate of prospecting and development and the quantity and rate of production under such plan." Prior to this last mentioned amendment, there had been some reluctance on the part of the owners of State and fee lands to join unit agreements containing the provision which was made mandatory by the 1931 Amendment requiring unit agreements to contain a provision vesting authority in the Secretary to alter or modify from time to time, in his discretion, the quantity and rate of production under the plan.

The 1946 Amendment also contained the following provision: "All leases operated under any such plan approved or prescribed by the Secretary shall be excepted in determining holdings or control under the provisions of any Section of this Act." This provision for the first time clearly removed all Federal leases committed to an approved cooperative or unit plan of operation from the acreage limitation of the Federal Mineral Leasing Act, although the 1931 Act had been construed to remove Federal acreage committed to cooperative or unit plans from the acreage limitations of the Act.

All of the leases which have been issued since the passage of the 1935 Amendment have contained a provision whereby the

lessee agrees within 30 days of demand to subscribe to and to operate under such reasonable cooperative or unit plan as the "Secretary of the Interior may determine to be practicable and necessary or advisable, which plan shall adequately protect the rights of all parties in interest including the United States."

From time to time the Department of the Interior has suggested forms to be used in connection with the unitization of Federal lands and has endeavored to have all proponents of unit plans involving Federal lands to follow as nearly as possible the suggested Federal forms. However, it was not until January 17, 1947,¹⁵ that a form of unit agreement was actually prescribed by the regulations of the Secretary. This form was later amended by a regulation which was approved by Secretary Chapman on December 22, 1950, and became effective January 4, 1951.¹⁶ Both of these forms follow, in substance, the forms which had theretofore been suggested by the Department with certain refinements and changes in language to put into practice the experience which had been gained in handling unit plans for a number of years. Those regulations also provide the manner in which areas are designated as suitable and proper for unitization and also for determining the depth of the initial test well to be drilled under the terms of the proposed unit agreement.

Under these regulations, in order to formulate and have approved a unit agreement involving Federal lands which are in an unproven area, it is necessary to file with the local Supervisor of the United States Geological Survey an application for designation of the proposed area as one logically subject to development under a unit plan of operation and for the purpose of determining the depth of the initial test well. It is necessary to accompany the application with a plat or map outlining the area sought to be designated, showing the different classes of lands involved and identifying the Federal leases by serial number. It is also necessary to submit with the application a geological report disclosing all of the information of the applicant with respect to geological or geophysical surveys which have been made of the area and information as to the depths probable producing formations are apt to be encountered. The applicant may request that the geological information submitted be treated as confidential.

If the application is found acceptable, a letter is usually written by the Director advising the applicant that a unit agree-

¹⁵Regulations of the Secretary of the Interior covering Unit or Cooperative Agreements, approved January 17, 1947 (Part 226), 30 CFR 189.

¹⁶Regulations of the Secretary of the Interior covering Unit or Cooperative Agreements, approved December 22, 1950; 30 CFR 226.

LEGAL ASPECTS OF UNITIZATION

57

ment will be approved for the area providing for the drilling of a well to a certain depth, if submitted upon an acceptable form and within a reasonable time. However, the Director reserves the right to deny approval of any executed agreement, which, in the Survey's opinion, does not have the full commitment of sufficient lands to afford effective control of operations under the unit agreement.

This procedure would, obviously, be somewhat modified in making application for the unitization of a proven area. In such cases, the form of unit agreement prescribed by Departmental regulations is usually modified to meet the peculiar conditions of the proven field or area, especially where there are considerable State and fee lands involved and, in some instances, even to the extent of modifying the royalty payable to the United States.

The form of unit agreement prescribed by Departmental regulations is not mandatory, but any substantial departure will not be permitted unless prior approval is obtained from the Department, and in the event the proponent contemplates using a different form or making changes in the regulation form provision is made for submitting the proposed form for approval of the Department prior to having the same executed by the necessary parties.

The owners of any interest in the oil and gas rights in any of the lands included within a proposed unit area are regarded as proper parties to the agreement, and the regulations provide that all such parties must be invited to join in the agreement, and in the event any party fails or refuses to join it is required that the proponent of the agreement submit with the agreement, at the time it is filed for official approval, a showing that the proponent has made a reasonable effort to obtain the joinder of each such party and giving the reasons for failure of each party to join. After the unit agreement has been submitted to the United States Geological Survey for final approval, if some of the mineral interests within the proposed unit area have not been fully committed, it is then determined by the Director whether or not sufficient interests have been committed to the unit to give reasonably effective control of operations under the agreement. As to what constitutes reasonably effective control, of course, is a matter within the discretion of the Director. There is no fixed percentage required but, ordinarily, practically all of the lands within the top closing contour of the geological structure or feature involved will be required to be committed before a unit agreement will be approved. Edge acreage, or acreage on the border of an area, is not considered absolutely essential to approval, and as to wheth-

er the omission or failure to have committed of any particular tract, will prevent approval of the unit agreement depends largely upon whether or not the United States Geological Survey considers such acreage as being so structurally located that it would prevent effective control of the entire area by the unit operator.

The Mineral Leasing Act permits the unitization of a part of a geological feature or structure, although it is not encouraged and it is doubtful whether portions of a projected unproven structure or area will be approved for unitization. In the case of a proven area, there may be particular circumstances which would make unitization of a portion of the field advantageous and, in such case, it would probably be approved.

Time will not permit me to analyze in detail the form of unit agreement which is prescribed by Department regulations.¹⁷ However, I would like to point out briefly some of the salient features. The unit operator designated in the agreement is given control of all operations carried on under the terms of the agreement. Provision is made for the working interest owners to enter into a separate agreement known as the "Unit Operating Agreement" for the purpose of agreeing upon the manner in which the working interest owners shall be entitled to receive their respective proportionate and allocated share of the benefits accruing under the agreement as well as for the payment of their share of all costs and expenses incurred by the unit operator. The usual form of agreement provides for the establishment of progressive participating areas, that is to say, upon the discovery of unitized substances in paying quantities that an area is designated with the approval of the Supervisor of the United States Geological Survey as an area reasonably proven by the discovery well, which, in many instances, is considered to be at least the adjoining 40 acre legal subdivisions. Within six months after the completion of a well capable of producing unitized substances in paying quantities, the unit operator is required to submit for approval of the Supervisor an acceptable plan for the development and operation of the unitized land. These plans are usually for one year at a time and are subject to being amended or supplemented to meet changed conditions. Separate participating areas may be established for separate producing formations or zones, and separate plans of development are usually submitted for each productive zone.

Unit plans may provide for a unit-wide participation, that is, for participation by all owners within the unit area; however,

¹⁷30 CFR. Section 226.12.

LEGAL ASPECTS OF UNITIZATION

59

this is usually limited to the working interest owners and is generally accomplished through the unit operating agreement by simply providing that the unitized substances shall be allocated to the lands within the participating area for the purpose of determining overriding royalty and other payments, and then distributed among the working interest owners in the proportion that their working interests on an acreage basis bear to all working interests committed to the unit agreement.

Where the unit covers unproven lands participation of the working interest owners is usually on an acreage basis; however, as to lands which are proven or semi-proven at the time the unit agreement becomes effective, participation may be on some other equitable basis, such as estimated reserves or potentials.

The Director of the United States Geological Survey does not approve the unit operating agreement, and the terms and conditions thereof are left largely to the discretion of the working interest owners. However, the regulations require that copies of the unit operating agreement be submitted with the unit agreement when it is submitted for final approval mainly for the purpose of showing that an acceptable agreement has been entered into by the working interest owners and that the provisions thereof are not in conflict with any of the provisions of the unit agreement.

The regulation form of unit agreement prescribed by the Department provides that any Federal lease issued for a fixed term of twenty years, or any renewal thereof committed to the agreement, shall continue in force beyond its fixed term until the expiration of the unit agreement. Any other Federal lease committed shall continue in force during the life of the unit agreement "provided unitized substances are discovered in paying quantities within the unit area prior to the expiration date of the primary term of such lease." Prior to the passage of the 1946 Amendment non-competitive Federal leases were issued for a term of five years, with a preference right to the lessee to secure a new lease by making timely application therefor as to lands embraced therein as were not classed as being on a non-producing structure as of the expiration date of the lease. The 1946 Act did away with the preference right leases and provides for a single extension of leases as to lands which are not on a producing structure as of the expiration of the initial five year term.

Section 17 of the Leasing Act, as amended, provides that, "leases other than twenty year leases committed to a cooperative or unit plan shall continue in force and effect as to the land committed so long as the lease remains subject to the plan, pro-

vided oil or gas is discovered under the plan prior to the expiration date of the primary term of such lease."

A question has recently been raised as to whether the leases issued since the passage of the 1946 Amendment which have been extended for an additional five years, will be extended by reason of being committed to a cooperative or unit plan where production is secured during the extended term rather than during the initial five year term. In other words, is the second five years to be considered as the "primary term" the same as the initial five years? The Solicitor for the Department of the Interior has held in a case involving the payment of compensatory royalty that the primary term means the initial five years.¹⁸ On account of this, there would seem to be a need for clarification of this question and it probably should be brought about by an appropriate amendment of the Leasing Act. Otherwise, it may be that leases in their extended term committed to a cooperative or unit plan will not be extended by production within the cooperative or unit area, as is ordinarily the case. If it should be so held, some of the most important features of unitization will be ineffective as to a great number of Federal leases.

The Federal regulations provide, in effect, that where State land is to be unitized, approval of the agreement by appropriate State officials must be obtained prior to its submission to the Department for final approval, and that when authorized by the laws of the State in which the unitized land is situated, appropriate provision may be made accepting such laws to the extent that they are applicable to non-Federal land.¹⁹ The regulations also provide, in effect, that where a field has been fully developed under a cooperative or unit agreement and the Federal land involved has less than 50% of the estimated recoverable unitized substances, that the Secretary may make portions of the Departmental operating regulations inapplicable to operations under the agreement with respect to the Federal lands involved.²⁰

In most cases, State leases which are committed to an approved unit agreement may be extended for the life of the unit agreement by appropriate provision in the unit agreement or in the certificate of consent or approval signed by State officials.

In the case of fee or privately owned lands, the Federal regulation form provides that they are to be extended during the life of the unit in the event of production within the unit area. In

¹⁸Memorandum : Mastin G. White, Solicitor to the Director, United States Geological Survey, April 9, 1947.

¹⁹30 CFR, Section 226.7.

²⁰30 CFR, Section 226.8(b).

LEGAL ASPECTS OF UNITIZATION

61

some instances, the Department has permitted a modification of this provision as an inducement to have fee owners commit their interest to the unit, to the effect that such leases will only be extended in the event unitized substances are being produced from some part of the lands embraced in the particular fee lease involved or if some portion thereof is included in a participating area prior to the expiration of the primary term of the lease.

In conclusion, I would like to point out that considerable progress has been made in connection with unitization during the last twenty years. The forms of unit agreements, and particularly some of the provisions thereof, are becoming more standardized and are being more generally accepted, much in the same manner as standard forms of oil and gas leases have been accepted in the past. Then, too, the industry now looks upon unitization more favorably than it did even but a few years ago. Unitization is in its infancy and, as time goes on, undoubtedly more and more oil and gas fields will be developed under unit agreements, which, ultimately, will contribute enormously toward the conservation of our natural resources.

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