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REPORT OF THE NATIONAL PETROLEUM COUNCIL'S COMMITTEE ON FEDERAL MINERAL LEASING ACTS

- SUBCOMMITTEE REPORT -

December 6, 1946

CHAIRMAN: W. H. FERGUSON

NATIONAL PETROLEUM COUNCIL
REPORT OF SUBCOMMITTEE
WITH RESPECT TO REGULATIONS APPLICABLE TO THE
FEDERAL MINERAL LEASING ACTS AS AMENDED BY THE
ACT OF AUGUST 8, 1946

Denver 2, Colorado
December 6, 1946

National Petroleum Council
Washington, D. C.

Gentlemen:

This report will supplement the preliminary report of October 31, 1946, of the undersigned Subcommittee appointed to consider and report upon the Regulations applicable to the Federal Mineral Leasing Acts as amended by the Act of August 8, 1946. The Regulations, as finally promulgated, were approved by the Acting Secretary of the Interior on October 28, 1946, and were not available to this Subcommittee at the time the preliminary report of October 31st was submitted. Our preliminary report should be read as one document.

Your Subcommittee, after a careful study of the new Regulations, not only without any desire but in a conscious effort not to be merely captious, emphatically objects to certain of the Regulations as entirely inconsistent with, or not warranted by any language contained in the Acts of Congress. There is attached to this report as an Appendix, recommendations for specific verbatim changes that should be made together with a brief statement of the reasons therefor.

Our objections may be summarized by reference to the particular parts of the Regulations involved as follows:

A. (191.8) So far as the acreage limitations are concerned, it was the clear intent of the Act of Congress to charge the

holder of an undivided interest in a lease with an amount of acreage equal only to his fractional part of the entire acreage embraced within the lease. This regulation improperly implies that the same party could not join in several different ventures with different associates in each instance, to test separate structures in various parts of a State if the total of all the acreage held in common (that held by A with B and C, plus that held by A with D and E, etc.), exceeded the statutory limitation. This may not have been the intention of the Department of the Interior, but the regulation, as promulgated, certainly needs clarification.

B. (192.1) This provision of the Regulations purporting to indicate in what respects the Act of August 8, 1946, is applicable to existing leases, restricts the language and intent of the acts of Congress, fails to indicate with any clarity what benefits of the amendatory act are automatically applicable to existing leases, and yet attempts to force the lessees of existing leases to exercise their election to be governed by the amendatory act within an arbitrarily prescribed limited time.

C.(192.4) This regulation is of vital importance if the development of the oil and gas resources of the Public Domain is to be encouraged and is, to say the least, confusing and ambiguous. While recognizing the validity of existing options, it would seem to mean no company or individual holding such options prior to June 1, 1946, shall be permitted to take any more options until his holdings have been reduced below 100,000 acres in any one State.

The Act of Congress, however, while limiting such options taken in the future to 100,000 acres in any one State at any time, expressly provides:

> "that nothing in this Section shall be construed to invalidate options taken prior to June 1, 1946, and on which such geological or geophysical exploration has been actually made and which are exercised within two years after the passage of this Act."

This is a matter of vital importance. It is also singular that at the public hearings held in Denver, Colorado, on September 30th, the tentative Regulations there submitted were entirely different in this respect, and that the position generally taken by the industry that all pre-existing options should be excluded from any acreage limitation seemed to be entirely acceptable to the Department officials.

D. (192.6) This section relates to the boundaries of known geologic structures and the productive limits of producing oil or gas fields and deposits, and the recommendations of your Subcommittee are set forth at length in the Appendix attached to this report. Briefly, however, it is recommended: (1) that time limitations be established within which the Department shall make its determinations of the boundaries of known geologic structures of productive limits of producing oil and gas fields, and also as to whether a discovery of new deposits has been made; (2) that the rules or general principles which will be followed by the Department in determining the productive limits of a producing oil or gas deposit be stated; and (3) that provision be made permitting the industry to rely upon maps of the boundaries of the geologic structure and of the productive limits of oil and gas deposits filed in the appropriate district land offices.

E. (192.80) This section deals with rentals and, in the opinionof your Subcommittee, the Department, by providing for an increase in the customary annual rental to 50¢ per acre on non-participating lands committed to a unit agreement, disregarded the explicit provisions of the act restricting the minimum royalty or discovery rental to the participating acreage.

F. (192.82) Your Subcommittee does not believe there is any statutory justification for the Secretary's fixing minimum prices for royalty oil or gas, but if the Department is determined to insist upon such a power, this Section of the Regulations should be amended so as to limit the fixing of minimum prices to situations where the existing market or posted price do not reflect real market value, and then only after a public hearing.

G. (192.83) Your Subcommittee believes that the Department should not attempt to limit overriding royalties to any arbitrary specified percentage, but only when the royalties are such a burden as to result in premature abandonment of wells.

H. (192.140, 192.141, 192.145) All of these sections of the Regulations relate to assignments or transfers of leases or interests therein. One of the greatest sources of irritation to the industry was the delay and uncertainty in having such assignments approved by the Secretary of the Interior. Extensive hearings were held upon this matter by the Senate Subcommittee, and it was the intention of the Act of August 8, 1946, to limit the power of the Secretary to refuse approval of an assignment to lack of qualification of the

assignee or sublessee, or for lack of sufficient bond. These Sections of the Regulations attempt, however, to extend the powers of the Secretary beyond the limits of the Act of Congress as an incident to the necessity of obtaining from the Department final approval of assignments. This entire matter is covered in detail in the Appendix attached to this report, and is of the utmost importance in removing one of the obstacles and deterrents to the fullest development of the oil and gas resources of the Public Domain.

I. (Lease Form) The regulations as finally issued include a lease form which was not submitted to the industry for criticism along with the tentative Regulations. However, throughout all of the discussions with the Department which preceded the passage of the Act of August 8, 1946, and in discussions with the responsible officials of the Department of the Interior since that enactment, the industry has been promised that the lease form would be reviewed and amended so as to eliminate objectionable features and especially burdensome clauses which tend to retard development. The industry has been promised that it would be given an opportunity to be heard on this particular matter. Our analysis of the lease form does not claim to be exhaustive or complete, but the points raised in the Appendix should, in our judgment, be called to the attention of the Oil and Gas Division, and the Bureau of Land Management by the National Petroleum Council.

J. (Restricted Indian Lands) While your Subcommittee was not specifically requested to report on the oil and gas regulations applicable to lands purchased under the authority of the Emergency Relief Appropriate Act of August 8, 1935, and administered by the

Secretary of the Interior through the Commissioner of Indian Affairs, we desire to call your attention to the oil and gas regulations promulgated on October 30, 1946, by the Assistant Secretary of the Interior. In Section 187.9 of these regulations, certain acreage limitations are prescribed, limiting the amount of this restricted Indian acreage which may be held to an amount which, when combined with the acreage held on lands of the United States under other leases, including leases issued under the Act of February 25, 1920, as amended, does not exceed a maximum of 2,560 acres within the geologic structure of the same producing oil or gas field, or a maximum of 7,680 acres in a single state. The last mentioned Regulations must have been prepared and promulgated entirely without reference to the Act of August 8, 1946, which expressly eliminated the limitation of 2,560 acres on any one structure, and increased the maximum acreage which could be held in a single state from 7,680 acres to 15,360 acres. There is considerable question as to the right of the Secretary to combine, for the purpose of computing acreage limitations, these restricted Indian lands with lands of the Public Domain, but in any event the regulations should be made to conform to the intent of the new Act of Congress.

While your Subcommittee believes that the objections, above summarized, to the new Regulations are of vital and far reaching importance, we have nothing but appreciation for the sound policy of the Department of the Interior in affording the industry every opportunity to be heard at the Denver hearings of September 30th

and October 1, 1946, before the new Regulations were finally promulgated. Many of the suggestions of the industry at those hearings were embraced in the new Regulations. Some of the objections pointed out in this report are fundamental and may necessitate a complete orientation of the viewpoint of the Department of the Interior. On the other hand, many of the objections are designed to assist the Department in clarifying and simplifying the Regulations so that prospectors undertaking to explore the oil and gas resources of the Public Domain may, in advance, be in as little doubt as possible as to what their rights will be, both before and after discovery.

Respectfully submitted,
W. H. Ferguson, Chairman
E. F. Bullard
H. H. Healy
A. C. Mattei
Gilbert Mueller
M. H. Robineau
R. S. Shannon
Subcommittee

PRELIMINARY REPORT OF SUBCOMMITTEE WITH RESPECT TO REGULATIONS APPLICABLE TO THE FEDERAL MINERAL LEASING ACTS AS AMENDED BY THE ACT OF AUGUST 8, 1946

Denver, Colorado
October 31, 1946

Mr. Walter S. Hallanan
Temporary Chairman
National Petroleum Council
Washington, D. C.

Dear Sir:

The undersigned Subcommittee, appointed by you to consider and report on the proposed revisions to the Regulations applicable to the Federal Mineral Leasing Acts, as recently amended by the Act of August 8, 1946, met in Denver yesterday.

Before the last meeting of the National Petroleum Council on September 26, 1946, the Department of the Interior had given widespread publicity to a notice of their intention to hold hearings at Denver, Colorado on September 30th and October 1st for the purpose of affording the Petroleum Industry, and any other parties interested, an opportunity to criticize and make any suggestions they deemed proper with respect to a tentative draft prepared by the Department of the Interior of new Regulations. Under Secretary Chapman, who presided at the September 30th hearing, announced that the revised Regulations submitted were purely tentative and the Department would welcome and give sympathetic consideration to any changes or additions which the industry, or any member of it, might suggest.

Prior to the hearing of September 30th, meetings were held in Denver, attended by representatives of the Rocky Mountain Oil and Gas Association, the Interstate Oil Compact, Independent Petroleum

Association of America, Mid-Continent Oil and Gas Association, Montana Oil and Gas Association, New Mexico Oil and Gas Association, California Oil and Gas Association, and others. The industry presentation at the hearing on September 30th was well organized and the views of the industry, for all practical purposes, had been almost completely harmonized in advance of the hearing. The suggestions submitted to Under Secretary Chapman and the other representatives of the Department of the Interior who attended the hearing with him were detailed and voluminous, and the Department was urged to expedite in every possible way the formulation and issuance of the new and revised Regulations.

The undersigned members of the Subcommittee appointed by you were not notified of their appointment until after the conclusion of the Denver hearing on September 30th and the informal discussions which followed on October 1st.

However, we proceeded at once to have a summary prepared of the principal industry suggestions submitted at the hearing on September 30th. The preparation of such summary, together with interlineations and additions to the tentative draft of Regulations necessarily required some time. The summary, as finally prepared, embraces more than 40 typewritten pages. Copies of such summary were mailed to each member of your Subcommittee, together with a notice of a meeting called for October 30th. It was not feasible to hold a meeting earlier.

Prior to our meeting of yesterday, we had been notified that the Department of the Interior had issued their revised Regulations as of October 25th, but we were unable to obtain a copy of the revised Regulations for consideration at the meeting yesterday.

Your Subcommittee concluded, after considering all phases of the matter, to wait until we had an opportunity to see and study the revised Regulations as promulgated on October 25th. It was hoped that many of the industry suggestions made at the Denver hearing on September 30th would be reflected in the revised Regulations as issued, and that it would be useless to recommend changes in the tentative draft which had already been embodied in the final Regulations.

Your Subcommittee accordingly adjourned until such time as the members have an opportunity to obtain and study the revised Regulations issued as of October 25th.

Respectfully submitted,

W. H. Ferguson, Chairman
E. F. Bullard
H. H. Healy
A. C. Mattei
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M. H. Robineau
R. S. Shannon

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APPENDIX TO

REPORT OF SUBCOMMITTEE OF NATIONAL PETROLEUM COUNCIL

WITH RESPECT TO REGULATIONS APPLICABLE TO THE

FEDERAL MINERAL LEASING ACTS AS AMENDED BY THE

ACT OF AUGUST 8, 1946

In order to facilitate reference to the changes recommended, the material in the present regulations which it is felt should be deleted has been crossed out and the material recommended for insertion has been added and underlined.

PART 191 - GENERAL REGULATIONS APPLICABLE TO MINERAL PERMITS, LEASES AND LICENSES

191.8 Interests held in common. An association shall not be deemed to exist between the parties to a contract for development of leased lands, whether or not coupled with an interest in the lease, nor between co-lessees, but each party to any such contract or each co-lessee will be charged with his proportionate interest in the lease. No holding of acreage in common by the same persons in excess of the maximum acreage specified in the law for any one lessee or permittee for the particular mineral deposit so held will be permitted.

In recognition of the practice of the Industry in taking leases as tenants in common for the purpose of drilling exploratory wells, thereby spreading the risk and permitting greater exploratory activities, Congress expressly provided in the Act of August 8, 1946, for such common ownership, but, in order to prevent any one group of co-lessees from acquiring too much acreage, applied the 15,360 acreage limitation to the holdings of any single group of co-lessees. The present regulations improperly imply that a party could not join in several different ventures, with different associates in each instance, to

test separate structures in various parts of a State, if the total of all the acreage held in common (that held by A with B and C plus that held by A with D and E, etc.) exceeded the statutory limitation. The suggested change is to conform the last sentence of the regulations to the statute and to clearly indicate that one person may become owner in common with several different groups of associates, provided, first, that his separate proportionate part of the acreage does not thereby exceed his acreage limitation of 15,360 acres in any one State and, second, that the same persons owning acreage in common do not exceed 15,360 acres in such common ownership in any one State.

PART 192 - OIL AND GAS LEASES

GENERAL PROVISIONS

The following text is substituted for Part 192:[1/]

192.1 Applicability of amendatory act and regulations to existing leases. ~~Prior to the filing of the notice of election hereinafter referred to, the act of August 8, 1946 (Public Law 696, 79th Congress) applies to leases issued prior to the date of that act only where the amendatory act so provides.~~ Certain provisions of the act of August 8, 1946, (Public Law 696, 79th Congress) grant new privileges and benefits to all leases issued prior to August 8, 1946, as well as leases issued after that date, and other provisions, because they impair or are in conflict with some vested right acquired under prior existing law, regulation, or lease form, apply only to leases issued on or after August 8, 1946, and to those issued prior thereto if the lessee files an election under section 15 of the act of August 8, 1946. Sections 192.40 to 192.44, 192.50 to 192.54, 192.70 to 192.72, both inclusive, of these regulations and the corresponding applicable statutory provisions apply only to leases issued on or after August 8, 1946, and to those issued prior thereto if the lessee files an election under section 15 of the act of August 8, 1946. All other sections of these regulations and the corresponding statutory provisions apply to all leases, regardless of date of issuance, unless the context specifically provides to the contrary.

~~1/ Leases heretofore issued until an election is filed as provided for in these regulations shall continue to be governed by the pertinent provisions of the regulations heretofore in force as well as by these regulations to the extent that they are applicable.~~

The pertinent provisions of the regulations heretofore in force continue applicable, until an election is filed as hereinafter provided, to leases issued prior to August 8, 1946, insofar as not inconsistent with such of these regulations as are applicable to such leases. The owner of any lease issued prior to August 8, 1946, may elect pursuant to section 15 to come entirely under the provisions of that act and of these regulations by filing ~~on-or before-December-31,-1948~~, a notice of election to have his lease governed thereby, together with the consent of surety if there be a bond on the lease, ~~a-notice-of-election-to-have-his-lease governed-by-the-amendatory-act~~. A notice of election so filed shall constitute an amendment of all provisions of the lease to conform with the provisions of the ~~amendatory~~ act of August 8, 1946, and the regulations issued thereunder. ~~No-right-of-election,-however, will-be-recognized-if-not-exercised-within-the-time-specified.~~

The present regulations with respect to the applicability of the amendatory act and regulations to existing leases require the owners of leases issued prior to August 8, 1946, to make an election within an arbitrarily prescribed limited time and yet do not indicate with any clairty at all what provisions of the amendatory act or the new regulations are applicable to the old leases. This has the effect of forcing parties to make an election at a time when they cannot be certain what the attitude of the Department is or what their rights actually are. In such cases it is the duty of the Department of the Interior to construe the Public Land Laws, and in this section of the regulations the Department should advise all lessees of the constriction that the Department intends to place upon the act of August 8, 1946, by pointing out just what provisions of that act and of the regulations the Department considers are applicable to the leases issued before the act of August 8, 1946, and which are applicable only to leases issued after that date.

The Department's present regulations contain an implication that certain provisions of the act of August 8, 1946, though apparently referring to leases generally, are not applicable to leases issued prior to the date thereof unless a notice of election is filed, and that the only provisions which are applicable to such leases are those which contain some specific and special wording to that effect. This position can only result from an improper construction of section 15 of the act of August 8, 1946, and is a construction which the Department itself does not uniformly adopt, as, in several instances where the act contains no such special or specific language, it recognizes in its present regulations that the act of August 8, 1946, does automatically apply to leases issued prior to August 8, 1946. Section 15 of the act of August 8, 1946, is merely a savings clause intended to protect vested rights acquired under prior existing laws, regulations, and leases, and the provisions of this section providing for filing notice of election were only inserted in order to establish an orderly procedure for permitting a lessee to voluntarily determine, in those cases where some benefit of the new act conflicted with some vested right acquired under an earlier law, which law should apply. If Congress had ever intended that the general provisions of the amendatory act should not apply to existing leases unless a notice of election should be filed, it would have certainly affirmatively stated such an important point and not merely left it to be implied from a provision in the saving clause which was clearly primarily inserted to cover instances where the terms of the amendatory act conflicted with vested rights granted under previous acts.

It is believed that the reports of the various Congressional Committees will substantiate the stand above taken and that it was the intention of Congress that the owners of leases theretofore issued should automatically receive, without any further action being taken upon their part, all the benefits and privileges of the amendatory Act that could be exercised and enjoyed without directly conflicting with some right acquired under the previous law.

Certainly, unless a clear and specific statement is made in the regulations as to each instance in which the provisions of the amendatory act are applicable to existing leases, no time limit can be imposed within which a lessee must file notice of the election provided in section 15 of the amendatory act.

> 192.4 Acreage limitations on options. ** *
> (e) No acreage shall be chargeable under options taken prior to June 1, 1946, on which geological or geophysical exploration has been actually made if exercised prior to August 9, 1948, ~~except as against the 100,000 acre limitation referred to in subsection (a) hereof~~, but no such option not so exercised will be recognized by the Department, thereafter, for any purpose. **

In the first place, with the inclusion of the deleted clause in subsection (e), the whole of 192.4 is confusing and ambiguous inasmuch as in subsection (a) thereof there is contained the affirmative statement that no optionee, except as permitted by the act of August 8, 1946, may hold options at any one time for more than 100,000 acreas in any one State. A reading of the act discloses, in our opinion, that the only exceptions to options in excess of 100,000 acres are options which were taken prior to June 1, 1946.

Options are mentioned in the Public Leasing Law for the first time in the August 8, 1946, amendment, and the type of options affirma-

tively permitted by the act to be entered into from and after June 1, 1946, are specified and that act then continues with the affirmative statement:

> "...that nothing in this section shall be construed to invalidate options taken prior to June 1, 1946, and on which such geological or geophysical exploration has been actually made and which are exercised within two years after the passage of this act."

It seems clear that Congress intended by this provision to recognize the validity and the inviolability of all options taken prior to June 1, 1946, and to provide a two year period after the passage of the amendatory act within which the holders of such options shall possess and exercise their rights pursuant thereto.

The option limitation provisions are contained in a sentence dealing with options entered into after June 1, 1946. Thus, both grammatically and by reason of accepted principles of statutory construction, there is no justification for interpreting the words "such options" as used in the limitation provisions as applying to options taken prior to June 1, 1946, which options are specifically dealt with in a proviso which follows and which is quoted above.

As a practical matter, the regulations in their present form would have the effect of prohibiting any further exploratory work by any company now holding options taken prior to June 1, 1946, in excess of 100,000 acres and force these companies to discharge or move out of the Rocky Mountain area their entire seismograph and exploratory crews.

When the regulations were originally proposed by the Department, and in the form in which they were at that time of the public hearings

in Denver, the clause which the Industry now objects to was not included therein. At the hearings the Industry generally expressed its opinion that all options taken prior to June 1, 1946, were not affected by any acreage limitation, and the representatives of the Department present at the hearing took no exception to those statements; nevertheless, when the regulations were finally promulgated, they inserted the language which does in effect impose the acreage limitation on such options inasmuch as it restricts companies holding at or over 100,000 acres of options from obtaining new options. Thus, the proposed change brings the regulation more nearly to its form as originally proposed and as considered at the public hearings.

The Industry submits that the change herein recommended is consistent with the proper interpretation of the act and with the purpose thereof and results in more fair and equitable treatment to all parties desiring to explore in the public domain.

> 192.6 <u>Determination of boundaries of known geologic structures, and productive limits of producing oil or gas fields and deposits, and discoveries of new deposits.</u> The Director of the Geological Survey will determine the boundaries of the known geologic structures of producing oil or gas fields and, where necessary to effectuate the purposes of the act, the productive limits of producing oil or gas deposits as such limits existed on August 8, 1946.
>
> <u>The productive limits of any producing oil or gas deposit as of August 8, 1946, shall in general be determined by conservatively applying the same principles as have heretofore been and are now being used by the Department in determining the limits of participating areas in cases where the unit agreement defined the participating area as constituting those lands reasonably proved to be productive of unitized substances in paying quantities, provided that in no event shall any lands be considered as lying within such productive limits unless such lands are situated at least within a half-mile radius of a well proved capable by August 8, 1946, of producing oil or gas in paying quantities.</u>

~~Any-lessee-or-his-operator-may-apply-to-have-a-determination-made as-to-whether-or-not-the-land-upon-which-he-intends-to-drill-a well-is-inside-or-outside-the-productive-limits-of-a-producing oil-or-gas-deposit.--The-application-should-be-accompanied-by-all available-geologic-data-which-in-his-opinion-have-a-bearing-on the-matter.~~ Any party desiring the determination of any such boundary or of any such productive limit may make an application therefore in triplicate to be submitted through the local office of the oil and gas supervisor and may in such application set forth his recommendation as to the proper boundary or productive limit for which a determination is sought, in which case the applicant shall also set forth in his application the facts, including geological maps, cross-sections, well data, and other geologic and engineering information upon which he relies to substantiate his proposed boundary or productive limit. Determination responsive to the application shall be made within forty-five days from receipt of the application by the office of the oil and gas supervisor; provided, that in cases where the different interests of lessees of more than one lease are involved a place, day and time certain, within said forty-five day period shall be fixed and a hearing upon such application open to all persons affected thereby shall be scheduled at said place, day and time and notice thereof shall be posted in the local district land office and shall also be given by registered mail to all such affected lessees at least thirty days prior thereto which notice shall also describe the boundary or productive limits, if any, recommended by the applicant; provided further, that unless the director has on or before the 10th day prior to said scheduled hearing, received notice in writing from an affected lessee or lessees other than the applicant that such party objects to the recommendations, if any, of the applicant and intends to be present at the hearing, or the director himself objects thereto, the director may by notice by registered mail given on or before the 8th day prior to said scheduled hearing to the parties to whom the notice of said scheduled hearing was mailed, cancel the hearing in which event the determination shall nevertheless be made on or before theexpiration of said forty-five day period. Determination by the Director shall be made public within fifteen days after the final date of the hearing, if one is held.

The director will also, upon application at any time by any lessee or operator, determine whether or not any production from any well then drilled or any production from a specified horizon in any well to be drilled is or will be considered as a discovery of a new deposit under the terms of the act. Such determination shall be made public within thirty days after the date of receipt of an application therefor, which application shall be filed in duplicate with the oil and gas supervisor of the district in which the land is located.

In order that every lessee may know in advance of drilling the royalty which will be required in case oil or gas should be found, no lessee shall be required to drill any well where the royalty rate upon the production from such well is dependent upon a determination to be made as above provided in this section, if he have an application therefor pending, until the necessary determination is made.

Maps or diagrams showing the boundaries of known geologic structures of producing oil or gas fields and ~~of~~ the productive limits of producing oil or gas deposits ~~will~~ shall, as such boundaries or productive limits are determined, be placed on file in the appropriate district land office and office of the oil and gas supervisor; and all parties in interest shall be entitled to rely upon the last posting or filing of such maps or diagrams, provided only that the director shall have the right to determine initially or revise the boundaries of any known geologic structure of a producing oil or gas field on the basis of the information furnished by the completion of any new well capable of producing oil or gas in paying quantities within 60 days after the completion of such a well, and to make such original determination or revision retroactive to the date of the completion of such a well.

It is very important that the Industry be able to determine, by maps or diagrams filed in the district land office or supervisor's office, the boundaries of known geologic structures of producing oil or gas fields and the productive limits of producing oil or gas deposits as such limits existed on August 8, 1946. The definition as to the boundaries is necessary in order that a party may know for certain as to whether or not he can obtain a non-competitive lease. Instances have occurred where, after an application for a non-competitive lease has been filed, the boundaries of a structure have been defined for the first time or modified long after the application has been filed so as to deny the applicant the right for a non-competitive lease. Furthermore, unless the productive limits of a producing oil or gas deposit are known as such limits existed on August 8, 1946, a party contemplating drilling a well cannot tell what the royalty rate will be if such

well should prove to be productive. It is, therefore, felt that section 192.6 should be modified so as to require, and establish an orderly procedure for obtaining the above mentioned determinations and also the determination of whether or not a new deposit had or would be discovered if certain contemplated drilling should be carried out.

It is also felt that the Department should state the rules or general principles which will be followed in determining the productive limits of producing oil or gas deposits in order that the Industry may be advised and assured of fair and uniform treatment. The formula above expressed is considered a reasonable definition in line with Congressional intent.

> 192.70 Preference right of patentee or entryman to a lease. ~~An-entryman-or-patentee-who-made-entry-prior-to-February-25, 1920,-or-an-assignee-of-such-entryman-or-a-vendee-of-such patentee-if-the-assignment-or-conveyance-was-made-prior-to January-1,-1918,-for-lands-not-withdrawn-or-classified-or-known to-be-valuable-for-oil-and-gas-at-date-of-entry-shall-be-entitled if-the-entry-or-patent-is-impressed-with-a-reservation-of-the-oil or-gas,-to-a-preference-right-to-a-lease-for-the-land.--A-settler whose-settlementwas-made-prior-to-February-25,-1920,-on-land-in the-same-status-but-which-has-since-been-withdrawn,-classified-or is-known-to-contain-oil-or-gas,-also-has-such-a-preference-right.~~
>
> ~~Any-applicant-for-a-lease-to-lands-owned,-entered-or-settled upon-as-stated-above-must-notify-the-person-entitled-to-a-preference-right-of-the-filing-of-the-application-and-of-the-latter's-preference-right-for-30-days-after-notice-to-apply-for-a lease.--If-the-party-entitled-to-a-preference-right-files-a proper-application-within-the-30-day-period-he-will-be-awarded a-lease,-but-if-he-fails-to-do-so,-his-rights-will-be-considered to-have-terminated.~~

It is the suggestion of the Industry that this section be eliminated in its entirety. The reason for this suggestion is that the preference right referred to is the preference right granted by section 20

of the original act of February 25, 1920. That section granted such a preference right to an entryman or patentee to obtain a prospecting permit. The act of August 21, 1935, abolished the permit system and consequently repealed by implication the preference right accorded by section 20. The saving clause in section 2 (b) of the act of August 21, 1935, did not purport to retain this preference right in existence and make it applicable to leases. Nothing in the act of August 8, 1946, purports to revive such preference right.

> 192.80 Rentals. Rentals on leases issued on or after August 8, 1946, and those issued prior thereto if the lessee files an election under section 15 of the act of August 8, 1946, shall be payable in advance at the following rates:
>
> (a) On non-competitive leases issued under section 17, wholly outside of the known geologic structure of a producing oil or gas field:
>
> (1) For the first least year, 50 cents per acre.
> (2) For the second and third lease years, no rental.
> (3) For the fourth and fifth years, 25 cents per acre.
> (4) For the sixth and each succeeding year, 50 cents per acre.
>
> (b) On leases wholly or partly within the geologic structure of a producing oil or gas field:
>
> (1) If issued non-competitively under section 17 and not committed to an approved cooperative or unit plan, beginning with the first lease year after the expiration of thirty days notice to the lessee that all or part of the land is included in such a structure and for each year thereafter, prior to a discovery of oil or gas on the leased lands, rental of $1 per acre.
>
> (2) If issued non-competitively, under section 1 or in any other way, and committed to an approved cooperative or unit plan which includes a well capable of producing oil or gas and contains a general provision for allocation of production, for the lands not within the participating area, ~~an annual rental of 50 cents per acre~~ the applicable annual rental provided for in subdivision (a) above for the first and each succeeding lease year following discovery.

(3) If issued competitively, an annual rental, prior to a discovery on the leased lands of $1 per acre unless a different rate of rental is prescribed in the lease.

(c) On leases issued in any other way an annual rental of $1 per acre.

The discovery rental of $1 per acre on leases issued prior to August 8, 1946, in cases where the Lessee has not filed an election under section 15 of the act of August 8, 1946, shall, if the lease is committed to an approved cooperative or unit plan which contains a general provision for allocation of production, be payable only on the participating acreage, and the applicable annual rental prior to discovery provided for in the lease shall be paid for the land not within the participating area.

Though the present regulation is not very clear, it would appear that is the Department's intention that the regulation apply only to leases issued on or after August 8, 1946. Therefore, following the idea expressed in our suggested section 192.1, a clause has been added indicating that subsections (a) to (c) inclusive apply only to leases issued on or after August 8, 1946, unless an election is filed.

Section 17 (b) of the act of August 8, 1946, contains the following provisions:

> "The minimum royalty or discovery rental under any lease that has become subject to any cooperative or unit plan of development of operation or other plan that contains a general provision for allocation of oil or gas shall be payable only with respect to the lands subject to such lease to which oil or gas shall be allocated under such plan."

This provision is general in its scope and offers a benefit which can be enjoyed without any conflict with any vested rights so it is felt that it is applicable to all leases and not just to those issued under section 17 of the act. A paragraph has therefore been added, indicating the applicability of the provision to the discovery rental of leases issued prior to August 8, 1946.

It is also felt that it was the intention and purpose of the above quoted provision to prohibit any increase being made, because of a discovery, in the rental payable upon that part of leases commited to unit agreements which lie outside of the participating area. Subdivision (b) (2) of the present regulations in effect increases the rental from 25 to 50 cents for lands not within a participating area upon a discovery. Requiring any rental in excess of the standard rentals established in subsection (a) above to be paid on non-participating lands because of a producing well being completed within the unit is in effect applying a discovery rental in a manner prohibited by the above quoted provision. The only alternative to this construction of the quoted provision would be to take the position adopted by some members of the industry that the subject provision automatically terminates all rental payments upon that part of a lease committed to the unit and lying outside the participating area.

> 192.82 Royalty on production. **
> (d) The Secretary of the Interior may, after notice and hearing establish reasonable ~~values~~ minimum prices for the purposes of computing royalty in value on any or all oil, gas, natural gasoline, and other liquid products obtained from gas when the existing prices do not reflect free and open market prices, but in no case shall the price established be more than the reasonable market value of the product, due consideration being given to the ~~highest~~ prices paid for ~~a-part-or-for~~ a majority of the production of like quality in the same field, to the price received by the lessee, to posted prices and to other relevant matters. ~~In appropriate-cases-this-will-be-done-after-notice-to-the-parties and-opportunity-to-be-heard~~.

The Subcommittee does not believe that there is any statutory justification for the Secretary fixing minimum prices in any instance, but as the Department appears determined to assume this power, it is

felt that this subsection should at least be revised to conform more closely to the attitude expressed by Secretary Krug in his testimony before the Senate Public Lands Committee when he stated that he had no objection to limiting his right to fix minimum prices in situations where the existing price did not reflect market value, and then only after a public hearing.

> 192.83 Limitation of overriding royalties. No overriding royalty interests, whether in the form of payments out of production or otherwise, which are in excess of 5 per cent or which, when aggregated with other overriding royalty interests on the same land theretofore created, are ~~aggregating~~ in excess of 5 per cent, shall be created except in a lease where the royalty payable to the United States is less than $12\frac{1}{2}$ per cent, unless limited by a provision that if and when the costs of operations, including the payment of such overriding royalty interests, shall be determined by the Director Bureau of Land Management, to constitute a burden on the lease prejudicial to the interest of the United States, such royalties and payments shall expire or be reduced to the extent required in order that the total overriding royalites shall not aggregate in excess of 5 per cent.
>
> ~~In such a lease the total royalty including that payable to the Government shall not exceed $17\frac{1}{2}$ per cent.~~ Where the royalty payable to the United States is less than $12\frac{1}{2}$ per cent, no such overriding royalty interest shall be created which, when aggregated with the royalty payable to the Government and all other overriding royalty interests on the same land, exceeds $17\frac{1}{2}$ per cent unless limited by the aforementioned provision. Contracts for payments out of production will not be construed to create an overriding royalty obligation where they provide that the obligation to make such payments shall be effective only during those periods when the average daily production from the lease is in excess of 15 barrels of oil per well per day.

There is no warrant in law for the Department limiting overriding royalties to any specified percentage, the only justification being that the overriding royalty shall not be a burden upon the leasehold which would result in premature abandonment of wells or wasteful production practices. The suggested revision of this section will give

the Government the protection it needs and is substantially the same as is provided in section 192.62 dealing with overriding royalties on renewal leases.

> 192.40 Assignments or transfers of leases or interests therein. Subject to final approval by the Director, Bureau of Land Management, leases may be assigned or subleased as to all or part of the leased acreage and as to either a divided or undivided interest therein to any person or persons qualified to hold a lease. ~~Subject to final approval by the Director, Bureau of Land Management~~, assignments or subleases shall take effect as of the first day of the lease month following the date of filing in the proper land office of all the papers required by sections 192.141 and 192.142. No assignment will be approved if the assignee is not qualified to take and hold a lease or if his bond is insufficient. An assignment of a separate zone or deposit or of a part of a legal subdivision will not be approved unless the necessity therefore is established by clear and convincing evidence.

Section 7 of the act of August 8, 1946, added a new section 30 (a) to the act and the provisions thereof changed the underlying theory relative to the approval of assignments of leases. Theretofore, the law had provided that assignments were valid only when approved by the Secretary of the Interior. The law now clearly reads that any oil or gas lease issued under the authority of the act may be assigned or subleased, subject to final approval by the Secretary, to any person or persons qualified to own a lease under the act and that the Secretary shall disapprove the assignment or sublease only for lack of qualifications of the assignee or subleasee or for lack of sufficient bond, and further provides that any assignment or sublease shall take effect as of the first day of the lease month following the date of filing in the proper land office of three original executed counterparts thereof, together with any required bond, and proof of the qualification under the act of the assignee or subleassee to take or hold such lease or interest therein.

In view of the complete change of the theory with respect to the freedom of lessees to assign or sublease, the regulations under the amendatory act should not attempt, by implication or otherwise, to thwart the new theory and delegate to the Secretary the old authority which he had under the act before its amendment. The Industry would prefer that sections 192.140 and 192.141 be revised along the lines suggested by the Industry at the September 30th hearing, but in view of the refusal of the Department to follow such suggestions, the Industry at least feels that the herein indicated changes in these sections should be made in order that it may be clear in the regulations, as well as in the law, that the Secretary does not possess the authority to approve or disapprove assignments and subleases that he did possess prior to the August 8, 1946, amendment.

The Industry cannot express too strongly its criticism of the of the Department in its attempts, both in preparing the regulations and in the administration of the law since the passage of the act of August 8, 1946, to take the position that it can merely withhold approval of assignments unless the parties comply with its various and arbitrary requirements not contained in the law. The law specifically states the two grounds upon which the Secretary may disapprove an assignment or sublease -- the lack of qualification of the assignee or sublessee, or the the lack of sufficient bond. Any refusal to act and approve an assignment after the statutory requirements are met and any attempts to suspend action thereupon until other arbitrary requirements are met is absolutely contrary to the law.

192.141 Requirements for filing assignments or transfers. All instruments of transfer of a lease or of an interest therein, including assignments of record title, working, or royalty interests, operating agreements and subleases, must be filed for approval within 90 days from the date of final execution ~~and must-contain-all-of-the-terms-and-conditions-agreed-upon-by-the parties-thereto~~, together with evidence of the qualifications of the assignee or transferee, consisting of the same showing required of a lease applicant by section 192.42(b) and (c) hereof. If a bond is necessary, it must be furnished. Where an assignment does not create separate leases, the assignee, if the assignment so provides, may become a joint principal on the bond with the assignor. ~~If-any-overriding-royalty-or payments-out-of-production-are-created-which-are-not-shown-in the-instrument, a-statement-must-be-submitted-describing-them.~~ Assignments of record title interests must be filed in triplicate. A single executed copy of all other instruments of transfer is sufficient.

The assignor or sublessor and his surety will continue to be responsible for the performance of any obligation under the lease until the assignment or sublease is approved. If the assignment or transfer is not approved, their obligations to the United States shall continue as though no such assignment or transfer had been filed for approval. After approval the assignee or sublessee and his surety will be responsible for the performance of all lease obligations notwithstanding any terms in the assignment or sublease to the contrary.

The lease account must be in good standing as to the area covered by the assignment when the assignment and bond are filed, or must be placed in good standing before ~~approval-will-be-given~~ the assignor or his surety will be discharged.

The reason for the changes in this section are the same as set forth under 192.140 above. In addition thereto, section 192.145 requires all instruments creating royalty interests to be filed, and the duplication of this requirement in this section implies that the approval of assignments may be withheld as a result of any failure to file a statement as to the overriding royalties created which, of course, is contrary to the specific provisions of the act stating the two grounds upon which assignment may be disapproved.

It is clear from the reasons heretofore given that the last paragraph of 192.141 must be deleted or changed in the manner suggested, inasmuch as under the law as it now stands, an assignee who is qualified to hold a lease cannot be deprived of his assignment by reason of any quarrel which the Department may have with his assignor.

> 192.145 Royalty interests in oil and gas leases and assignments thereof. Royalty interests in oil and gas leases constitute holdings or control of lands and deposits within the meaning of the first sentence of section 27 of the act. Assignments of such interest must be filed for record purposes in the appropriate district land offices accompanied by a showing by the assignees as to their citizenship and holdings in other oil and gas leases in the state. All assignments of royalty interests must be filed for the record, but, unless specifically requested, only those of more than 1 per cent will be approved and then only after discovery.

The Department has always taken the position that a royalty interest is an interest in the lease and under the act assignments of such interests are subject to final approval by the Secretary. In order to prevent the argument that royalty interests of not more than 1 per cent might be invalid unless approved, the suggested change in this section would permit a cautious royalty holder to obtain approval although his interest is not more than 1 per cent. Even such a small royalty interest might, especially in the case of such a royalty interest over a whole unit area, represent a very considerable sum of money, and the holder thereof should not be restrained in his right of alienation or have a cloud put upon his title by being unable to obtain proper approval of the Secretary.

LEASE FORM

The Industry regrets that it was not given an opportunity, as it has requested, to comment upon the lease form prior to the final adoption. From a very hurried review of the lease form approved, it is evident that the effect of the Department's acting in this important matter without consulting the Industry has resulted in many inequitable provisions being inserted in the form and that in several cases in so acting the Department has exceeded any discretionary authority vested in it under the law. The following examples are illustrative of this point:

1. In section 2 (d) (3) a new clause has been inserted requiring that when royalties are paid in amount of production they be delivered "in merchantable condition on the premises where produced without cost to lessor unless otherwise agreed to by the parties hereto." This provision might well be construed as requiring the lessee to process casinghead gas and deliver to the Government the royalty portion of the casinghead gasoline free of any cost of manufacture. This is contrary to the provisions of the Leasing Act requiring delivery "in amount". The courts have in many cases defined language such as this to require only delivery of the products at the well head without treatment.

2. Section 2 (e) prohibits the sale or disposal of products except in accordance with a contract or arrangement first approved by the Director of the Geological Survey and finally by the Secretary of the Interior. As considerable delay is often encountered in obtaining the proper approval, particularly the final approval by the Secretary,

some provision should be made so as to protect the lessee during the interim period when his contract is on file pending action by the Director or Secretary.

3. Subdivisions (f), (g) and (h) of section 2 require, among other things, that the lessee file reports of his investment, depreciation, and costs, and acceptable records of all subsurface investigations affecting the lands and permit inspection of all his records relative to operations and surveys or investigations on the leased lands. There is no justification whatsoever for requiring any lessee to reveal his operating or investment costs or the results of his seismograph or other geological information upon the lease lands. These are confidential matters, and there is no provision in the lease or regulations prohibiting the dissemination or release of any information so obtained. A lessee paying the costs and expense of seismograph work or geological surveys should be entitled to obtain the full benefit from his work prior to revealing the results to the public.

4. Section 2(l) contains the non-discrimination stipulation which has been inserted in the lease form in spite of the fact that Congress has on several occasions defeated legislation which would require the insertion of such provisions.

5. A new clause has been added to section 2(n) which has the effect of requiring any party owning any Government lease in a field and purchasing any products from the field to purchase "at reasonable rates and without discrimination the oil and gas of the Government or

of any citizen or company not the owner of any pipe line operating a lease". This clause might well be interpreted to require a purchasing party to buy the oil of the Government or of any party operating a Government lease at a rate considered reasonable by the Secretary even though other oil was obtainable in the field at a lower rate.

6. The provisions of section 2(r) and section 6 requiring delivery of the leased premises with all permanent improvements thereon in the event of forfeiture and giving the Government the right, within three months after the termination of a lease, to purchase all materials, tools, machinery, appliances, structures, and equipment placed upon the lands by the lessee, are arbitrary and unduly burdensome. While it is proper that provisions of this sort be imposed with respect to casing installed in a well and required for the preservation thereof, there is no justification for the scope of the inserted provisons.

Certain changes have been recommended above with respect to certain sections of the regulations, including 192.82 (d), 192.140, 192,82, and 192.83. The adoption of the changes recommended will, of course, necessitate appropriate changes in the corresponding sections of the lease form, that is, sections 2 (d) (2), 2 (m), schedules (a) to (d), inclusive, and section 2 (q), respectively.

The Subcommittee has not had an opportunity to assemble the comments from all the various representatives in the Industry upon the new lease form, but the above comments indicate that the lease form, as approved, is inequitable and that some further consideration should be given towards soliciting the comments of the Industry before adopting a final lease form. In the meantime, changes consistent with such changes as are made in the regulations must be made.

PART 187 - TITLE 25 OF CODE OF FEDERAL REGULATIONS APPLICABLE TO LANDS PURCHASED UNDER THE AUTHORITY OF THE EMERGENCY RELIEF APPROPRIATION ACT OF AUGUST 8, 1935

On October 30, 1946, the Assistant Secretary of the Interior published certain regulations with respect to the leasing for oil and gas and other mining purposes of certain lands purchased under the authority of the Emergency Relief Appropriation Act of August 8, 1935, and administered by the Secretary of the Interior through the Commissioner of Indian Affairs. In Section 187.9 of these regulations is set forth certain acreage limitations limiting the amount of acreage which may be held thereunder to an amount which, when combined with the acreage held on lands of the United States under other leases, does not exceed a maximum of 2,560 acres within the geological structure of the same producing oil or gas field or a maximum of 7,680 acres in any single state.

It is submitted that there is absolutely no justification for combining, for the purposes of computing acreage limitations, the amount of the subject Restricted Indian acreage held with that held under other acts, including the Oil and Gas Leasing Act of February 25, 1920. This last mentioned act, as amended, contains no limitation upon the amount of acreage which may be held upon one structure and permits 15,360 acres being held within each state. Any party holding over 7,680 acres under the Oil and Gas Leasing Act within a state or over 2,560 acres with any geologic structure would be prevented from acquiring any of the subject

Restricted Indian acreage whatsoever. Furthermore, this regulation, in effect, would deprive a lessee of his statutory right under the Oil and Gas Leasing Act of February 25, 1920, to hold 15,360 acres of public domain land in any one State, because, if he also held any of the Restricted Indian land, then the maximum public domain lands that he could hold without having to surrender his Restricted Indian lands would be an amount which, together with his Restricted Indian lands, did not exceed, not 15,360, but only 7,680.

In the Congressional hearings which led to the passage of the Act of August 8, 1946, the elimination of the structural limitation was not only advocated by the industry with respect to public domain lands, but was ardently supported by the Department of the Interior. It hardly seems logical to now impose a structural limitation on the subject Restricted Indian lands. The very reasons urged by the Department for the elimination of the structural limitation under the Act of February 26, 1920, are equally applicable to elimination of any structural limitation on the subject lands.