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MUNICIPAL INTERACTION WITH THE

OIL AND GAS INDUSTRY

BY

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I. INTRODUCTION

This paper is designed to give city attorneys in Kansas the basic background necessary to advise city officials on the use, development, and regulation of oil and gas resources within a city's jurisdiction. The concepts discussed go far beyond mere oil and gas regulation. Instead, I have elected to address how cities in Kansas can create programs to develop their oil and gas resources for the benefit of the city, individual landowners, and the public at large. Cities have sometimes reacted to oil and gas development in or around municipal boundaries by passing ordinances which unnecessarily burden the developer; often such responses make operations impossible, impractical, or economically unfeasible. One of the major goals of this paper will be to demonstrate what the city can do to enhance the development of its oil and gas resources while providing the necessary protection of the public health, safety, and welfare.

Cities in Kansas have the authority, and the opportunity, to take specific steps to promote the orderly development of oil and gas within their jurisdiction. Cities attempting to provide quality municipal services with dwindling budgetary resources are beginning to search for new income sources. Oil and gas lease revenues constitute one source many cities may be able to develop. More often, however, cities have adopted a passive response, reacting to oil and gas development solely through regulation. This paper offers cities an alternative approach in which the city actively participates in the development of oil and gas resources; such an approach permits the city to maximize the economic value, recovery, and conservation of these vital natural resources.

The following sections address "why" the city should be concerned with oil and gas development, "what" resources the city has to develop, and "how" the city can promote development. This will be followed by a discussion of the basic ordinances, resolutions, and contracts required to complete the development process. Development problems which the city may encounter are also considered. The final section addresses municipal regulation of development.

Before considering the various aspects of municipal oil and gas activities, it is necessary to address some of the basic physical and legal principles which control oil and gas development. Once the mechanics of the oil and gas reservoir are understood, and the legal regime directing their development identified, the parameters for a municipal development program can be established.

II. PHYSICAL AND LEGAL PRINCIPLES

AFFECTING THE DEVELOPMENT OF OIL AND GAS

A. MECHANICS OF THE OIL AND GAS RESERVOIR

Contrary to popular belief, oil and gas are not found in large underground caverns or flowing subterranean rivers. Oil and gas are normally found in sedimentary rock which has the physical properties of porosity and parmeability.[1] To have porosity, the rock must possess spaces unoccupied by rock material. Consider the porosity of a cup of granular sand having many small spaces between individual grains, permitting the sand mass to absorb water within the spaces. Porous rock can contain oil and gas in the spaces unoccupied by the rock material.

The degree of rock porosity will determine how much oil, gas, and water can be held by the rock. If the rock has a high porosity, much free space exists for the accumulation of oil, gas, and water. If the rock is not porous, or has a low porosity, oil and gas in commerical quantities will most likely be absent. Even though the rock is highly porous, it must also be permeable. Permeability refers to the ability of fluid in the porous rock to be transmitted through interconnecting pores from one part of the reservoir to another. The permeability of the rock determines whether the oil and gas within the rock spaces can be transmitted through the reservoir to a well. If the rock is impermeable, or has a low permeability, the oil and gas will not flow and will remain trapped in the rock spaces. Rock having a high permeability will allow the oil and gas to push through rock spaces towards the well bore. A connected bed of porous and permeable rock which contains oil and gas is called a "reservoir".

High permeable rock with good porosity must be contained within natural barriers for oil and gas to accumulate. If oil and gas in the reservoir rock are not restrained, they will rise to the surface of the earth. Oil and gas producing reservoir rock is found in various geologic "traps" beneath the earth. The reservoir rock is surrounded by impermeable rock which locks oil and gas into the porous and permeable rock.[2] With the oil and gas "trapped" beneath the earth, the next problem is how to go about recovering them from the reservoir.

Oil, gas, and water are usually found together in a reservoir.[3] A thin film of water is usually found lining the reservoir rock spaces.[4] Oil and gas partially displace this water.[5] Water may also be found at the bottom portion of the reservoir. Water, being heavier than oil or gas, will settle out in the lower zone of the reservoir. Oil, being heavier than gas, tends to settle out from the gas. The reservoir therefore may have three distinguishable zones with a gas cap, oil in the middle, and water at the reservoir floor.[6] However, gas will also be found assimilated into the oil when under pressure.

The reservoir in its natural state is under pressure. The reservoir pressure and the materials within the reservoir are static prior to drilling into the reservoir. Once the reservoir is breached, the oil and gas under pressure will move towards the low pressure zone created by the well.[7] The permeable rock permits the oil and gas to migrate toward the well. Energy needed to push the oil and gas through the permeable rock is provided by the force of gravity, expansion of gas in the reservoir, and water encroaching into the oil zone as oil and gas are removed.[8]

There are three basic drive mechanisms which may operate to create the reservoir pressure necessary to move oil and gas toward a well: (1) dissolved-gas expansion; (2) gas-cap expansion; and (3) water encroachment.[9] Gravity drainage will aid each mechanism if production is properly regulated. Each requires special engineering considerations to make efficient use of the natural reservoir energy for maximum oil and gas recovery.

With this brief background of the physical principles of the oil and gas reservoir, the legal principles can be examined. As will be seen, the physical principles of the reservoir are often ignored to accommodate principles of property law.

B. LEGAL PRINCIPLES

1. OWNERSHIP

The early common law of property, forged by courts when populations were small and natural resources abundant, recognized extensive rights in the property owner. The policy of the common law was to assign to identifiable owners everything capable of ownership.[10] Pursuant to this goal, surface ownership of land included ownership to all that lay below or above the confines of the surface boundaries of the land.[11] Blackstone summarized the rule stating: "(T)he word 'land" incudes not only the surface of the earth but everything under it, or over it."[12]

Oil and gas property rights are initially determined according to surface boundaries. Artificial lines drawn upon the earth's surface control, to a large extent, development of the oil and gas below. The United States Supreme Court first considered ownership of oil and gas in Brown v. Spilman,[13] which concerned disputed drilling rights on land in West Virginia. In its opinion, the Court commented: "Petroleum gas and oil are sustances of a peculiar character . . . . They belong to the owner of the land, and are part of it, so long as they are on it or in it, or subject to his control . . . ."[14] The Court seemed to have recognized ownership of the oil and gas in place as part of the real property.[15]

Five years later, in Ohio Oil Co. v. Indiana,[16] the Court upheld an Indiana statute prohibiting excessive waste of natural gas in the production of oil. The gas was released when oil was lifted from the reservoir. To comply with the statute, Ohio Oil would have had to cease its oil production operations. The statute was attacked as an unconstitutional taking of the oil in the ground.

To evaluate the taking claim, the Court had to determine Ohio Oil's property interest in the oil and gas. Applying Indiana decisions on the subject, the Court found:

> Although in virtue of his proprietorship the owner of the surface may bore wells for the purpose of extracting natural gas and oil, until these substances are actually reduced by him to possession, he has no title whatsoever to them as owner. That is, he has th exclusive right on his own land to seek to acquire them, but they do not become his property until the effort has resulted in dominion and control by actual possession.[17]

This approach, which recognizes no ownership in oil or gas until actually produced, has become known as the "non-ownership theory".[18] Contrast the non-ownership theory to the "ownership-in-place" approach, which treats oil and gas as part of the land, and subject to ownership, while "on it or in it, or subject to his control."[19]

Ownership issues have generally been decided by using an ownership-in-place or non-ownership approach. "Qualified ownership" has been offered as a third approach by some state courts and provides:

> That oil and gas are a part of the land and belong to the owner thereof as long as they remain in or on the land; upon migration to another tract the title of the former owner is lost.[20]

Distinguishing the three theories, when the rule of capture applies, is difficult. Courts in the same jurisdiction have often adopted differing ownership theories depending upon the issue involved, creating considerable difficulty in reconciling their decisions.

Kansas has adopted the ownership-in-place rule.[21] The Kansas Supreme Court, in Richards v. Shearer,[22] had to determine whether a certain mineral conveyance transferred the right and title to oil and gas in place to the defendant grantee. The court clearly distinguished a conveyance of mineral rights, which in Kansas "created a present estate in oil and gas in the ground",[23] from a transfer of leasehold rights, which created merelv a right to explore for and produce oil and gas.

2. RULE OF CAPTURE

Regardless of the ownership theory used, the ultimate ownership of oil and gas will be determined by the "rule of capture". The rule of capture recognizes that oil and gas in the reservoir will move from areas of high pressure towards areas of lower pressure. The low pressure areas are created by opening the reservoir with a well. The rule of capture vests title in the developer to whatever is produced from wells bottomed in his land, even though some of the oil or gas has moved across surface boundary lines from adjoining lands not leased or owned by the developer.

Courts first attempting to define righs inoil and gas lacked knowledge of their behavior in the reservoir.[24] They were likened to a free-flowing subterranean river, respecting no surface boundary and not subject to quantification or allocation among surface owners.[25] Out of necessity, courts fashioned a rule to govern appropriation of oil and gas which avoided allocation problems. Courts adopted the rule of capture by drawing analogies to the law of wild animals[26] and percolating waters.[27] Ownership under the rule was subject to prior capture of the resource.[28] Wells properly drilled and bottomed on a person's land could be used to drain oil and gas from under other lands. The sole remedy of adjacent landowners was to exercise their right to capture to do likewise.[29]

The doctrine of capture continues today as the underlying property law of oil and gas. Ownership concepts were molded around rule of capture. Regardless of the ownership theory in effect, the rule of capture prevails as the guiding principle for determining ultimate ownership in oil and gas.

However, the rule of capture has created many problems requiring limitations to protect private property and public conservation interests. The "correlative rights doctrine" was created to limit the rule of capture by creating reciprocal rights and duties between landowners overlying a common reservoir.

3. CORRELATIVE RIGHTS DOCTRINE

The correlative rights doctrine recognizes the connected nature of the oil and gas reservoir and that a person operating a well properly located on their land can significantly affect the rights of other property owners in the same reservoir.

Professor Kuntz had identified four basic rights of owners overlying a common reservoir; they include:

1. (T)he right against waste of extracted substances,

2. the right against spoilage of the common source of supply,

3. the right against malicious depletion of the common source of supply,

4. the right to a fair opportunity to extract oil or gas.[30]

The Conservation Division of the Kansas Corporation Commission defines "correlative rights" as follows:

> (14) Correlative rights means that each owner or producer in a common source of supply is privileged to produce from that supply only in a manner or amount that will not injure the reservoir to the detriment of others, take an undue proportion of the obtainable oil or gas, or cause undue drainage between developed leases.[31]

The Kansas Corporation Commission is given the power, by statute, "to prevent the inequitable or unfair taking of crude oil"[32] which would be "injurious to the respective correlative rights of the producers"[33] in a reservoir. Similar statutory powers are given the Commission with regard to natural gas.[34] Cities, in directing oil and gas development, must consider the effect of their regulations on the correlative rights of mineral interest owers within the city's jurisdiction. The main problem within the city will be establishing a program which will give mineral interest owners a fair opportunity to extract oil or gas. However, correlative rights can be subordinated to protection of the public health, safety, and welfare.[35]

The term correlative rights is often used in two differing contexts. First are what may be called "common law" correlative rights. These are the basic rights identified by Profesor Kuntz which require each interest owner in a reservoir to use the oil and gas resource so as not to unreasonably interfere with the common rights of others. The other type of correlative rights can be termed "statutory." Such rights are usually specified when the rule of capture is limited by conservation regulation. When the state places limits on a developers right of capture, it must attempt to regulate in such a manner as "to prevent . . . inequitable or unfair taking" between common owners in a reservoir.[36] In Kansas, such "statutory" correlative rights only protect "developed" leases from uncompensated drainage through capture.[37] However, the Kansas Legislature, by statute, and the Corporation Commission, by regulation, have provided some protection for undeveloped leases through well location,[38] spacing,[39] and production limitations.[40]

Production and well spacing limitations come under the general heading oil and gas "conservation." These and other conservation techniques impose additional limitations on the rule of capture to protect public and private interests in the oil and gas resource.

4. CONSERVATION REGULATION

Conservation laws seek to protect public interests in the oil and gas resource through the prevention of "waste." Waste of oil and gas generally refers to production techniques or practices which fail to maximize the use of natural reservoir forces to obtain the greatest ultimate recovery of oil and gas possible.[41] Waste, however, is a generic term which includes many facets of rational development and use of the oil and gas resource. Waste includes development and operation practices which result in a physical loss of oil or gas, or which reduce the amount of oil or gas ultimately recoverable from a reservoir. Waste may include utilization of the resource for inferior purposes which fail to effectively exploit its energy content.[42] Unnecessary capital investment to recover the resource may be deemed "economic waste."[43] Waste of oil and gas have been prohibited by common law limitations on the rule of capture[44] and through statutory and constitutional provisions regulating waste of these natural resources.[45] Waste of oil and gas in Kansas is defined by statute to include economic waste, underground waste, surface waste, waste of reservoir energy, and the production of oil or gas in excess of transportation or marketing facilities or reasonable market demand.[46]

Production controls such as minimum well-spacing distances, market demand requirements, and well and reservoir production limitations make up the primary scheme for waste prevention. "Pooling" of separate interests is used to accommodate rational production under spacing rules. "Unitization" has emerged as the engineer's preferred means to prevent waste and combat the ill effects of the rule of capture. All of these waste prevention regulation measures are collectively known as "conservation."

The primary conservation technique employed by Kansas is "prorationing." Prorationing in Kansas is accomplished by first forecasting the "market demand"[47] for oil and gas and then allocating the total demand for Kansas oil and gas among the various "pools" (reservoirs) in the state. Each pool's share is then "prorated" among the wells in the pool. To determine how much of the pool "allowable"[48] each well can produce, the well's "productivity"[49] must be considered in connection with the "acreage attributable"[50] to such well. This figure is then compared to the productivity and acreage attributed to all other wells in the pool to arrive at the percentage of the pool allowable the well can produce.[51]

Another common conservation measure is well spacing which requires that each well be located a minimum distance from lease lines, property boundary lines, or other producing wells. The goal is to promote orderly development and prevent economic and physical waste which otherwise can occur under the rule of capture. Correlative rights are also protected through proper well spacing.[52] Once a spacing unit is designated, the operator may have to bring in acreage beyond the leased acreage to meet the minimum acreage requirement for the spacing unit. For example, assume the spacing order calls for development on the basis of one well for each governmental quarter quarter section (40 acres). You have a lease on the South half of the quarter quarter section (20 acres). The North half is unleased. Neither tract is entitled to a well. However, the North and South halves of the quarter quarter section can be "pooled" to form the required 40 acre spacing unit. In such a case, the owners in each half will be entitled to a 50% interest in production from the well. This process of combining interests necessary to create a spacing unit is referred to as "pooling."

Pooling is absolutely essential for the orderly development of a spaced reservoir. Most states have voluntary and "compulsory" pooling to effect the required consolidation of interests to form spacing units. Kansas is the only producing state which lacks a workable compulsory pooling system.[53] As will be seen, this is one area where cities can provide the developer with some relief while protecting the correlative rights of all parties.

Unit operation, or unitization, is the operation of a reservoir as a single unit. The reservoir is developed as a unit in such a manner as to maximize its productive capacity with the least amount of physical or economic waste. Surface boundaries are used only to calculate each party's share in the total production from the reservoir. The rule of capture is nullified and each owner is compensated for the recoverable oil and gas beneath their property. Unit operation is the most efficient method of recovering oil and gas.[54]

The physical and legal principles discussed in this section will be elaborated upon and applied when municipal development and regulation problems are examined in later sections of this paper. However, before considering the details of municipal operations, we must consider "why" a city would want to get involved with development of oil and gas resources.

III. MUNICIPAL INVOLVEMENT WITH THE DEVELOPMENT OF OIL AND GAS

Perhaps the first question a city governing body may pose in the face of oil and gas development is: why should the city get involved? Usually the city has little choice in the matter. Once development is proposed, the city will have to become involved. The city can take one of three general approaches to regulating oil and gas development. First, the city can prohibit all oil and gas development activity within its jurisdiction.[55] Such a prohibition will be upheld when it is reasonably related to protecting the public health, safety, and welfare. A second approach is to permit oil and gas development in certain zones of the city subject to numerous restrictions. The third approach requires the developer to comply with restrictions necessary to protect the public health, safety, and welfare, but also enlists the city's active participation to package, market, and orderly develop oil and gas resources within its jurisdiction.

Besides the city's responsibility as a regulator, the city may want to promote development hoping to obtain a new source of income for the city and to improve the local economy. The city may obtain income through lease bonuses, delay rental payments, and payments based upon production, such as royalty or a share in the working interest of a well. Other landowners in the city may also obtain income from development on or attributable to their property.

The city may also become involved in oil and gas development to protect its resources from being drained by operations outside the city's jurisdiction. As was noted in Section II of this paper, oil and gas will migrate within the reservoir towards areas of lower pressure. Wells drilled in a reservoir on land located outside the city limits can drain oil or gas from parts of the reservoir which extend under the city. The rule of capture would permit the operator outside the city to obtain title to all oil and gas which

it can produce through wells bottomed in its lands, even though the oil or gas has migrated from beneath property within the city. Although the city may attempt to protect its oil and gas resource through minimum well set back requirements, the only effective remedy for the city is to take affirmative action to capture the oil and gas before it is able to migrate towards other wells.[56] This will require the city to get involved in oil and gas development.

The city may also choose to promote development in hopes of obtaining new energy resources at competitive prices. For example, development near the city may make new gas supplies available for the city to purchase and use at favorable prices.

Often, another benefit to the governing body undertaking development will be to "end the debate" about the existence of oil and gas within the city's jurisdiction. The "debate" characteristically rages with each new development near the outskirts of the city. The best way to end such periodic debates is to permit development within the city. After a city recognizes the potential need and benefits for oil and gas development within its jurisdiction, the next question concerns identifying property the city has available for development.

IV. MUNICIPAL LANDS AVAILABLE FOR OIL AND GAS DEVELOPMENT

A. CITY PROPERTY

Most cities have in their possession a substantial amount of property which could be made available for oil and gas development. When discussing property available for "development," it must be understood that a well does not have to be physically present on the property in order for it to share in the economic benefits of production. This can occur in two ways. The first is use of directional drilling techniques. Oil and gas under the city hall building can be produced through wells drilled on nearby lands which have their well bore bottomed under property which cannot be occupied from the surface. Directional drilling could also permit, in some cases, the removal of oil and gas from other areas in the city which, due to zoning or other considerations, will not permit the location of a well directly above the target area. However, directional drilling has many economic limitations, and physical limitations when attempting to drill for relatively shallow deposits.

The second way to obtain the economic benefit of oil or gas under a tract of land, without physically occupying the surface with a well, is to establish "drilling units" and "pool" all interests within the drilling unit. A drilling unit is a specified area designated for the location of a single well. For example, the city may designate drilling units consisting of four contiguous city blocks and permit a single well to be drilled, as nearly as possible, on property located near the center of the drilling unit. To protect correlative rights, and to prevent waste, the city would want to provide for the consolidation or "pooling" of all lands within the drilling unit. The effect of such pooling would be to permit each mineral interest owner to share in production from the well on the drilling unit area in thej proportion their mineral interest bears to all interests in the drilling unit. This would permit an equitable sharing of oil and gas produced from the drilling unit without each tract owner having to drill a well in their front yard to

develop, and thereby protect, their mineral interest. It would also permit the city to share in production from under land which cannot be physically occupied by a well.

Even though the city cannot have a well located on its property, it can still participate in the economic benefits from acreage it owns which is attributable to a well in a drilling unit or which is developed through directional drilling. It therefore becomes necessary to consider municipal property which the city could obtain direct income from if developed.

Although each conveyance to the city must be carefully reviewed for limitations and restrictions on use of the property, the city may have many area available for development.

Consider the following types of municipal property:

1. Parks
2. Cemeteries
3. Public Buildings
4. Streets
5. Alleys
6. Landfill
7. Industrial Park
8. Sewage Treatment Plant
9. Water Treatment Plant
10. All Other Municipal-Owned Real Property

B. PRIVATE PROPERTY

In addition to municipal property, a substantial amount of private property can be developed under appropriate local regulation. All that is needed is a workable city ordinance and a landowner willing to permit operations on their property.

With lands available for development, the city next must determine what role it will take in the development process. Although the city elects to allow development within its jurisdiction, it must decide whether it will merely regulate or, in effect, promote development.

V. MUNICIPAL PROMOTION OF OIL AND GAS DEVELOPMENT

After the city determines it will permit oil and gas development within the city, it must consider whether to take an "active" or "passive" approach to development. The passive approach merely creates a workable regulatory atmosphere, allowing development to grow without any encouragement by the city. The active approach goes beyond passive regulation and actually gets the city involved in promoting orderly development by creating interest in the area, making lands available for development, and making it relatively simple for operators to acquire acreage and develop prospects within the city. The author favors the active approach and offers the following guide for initiating an active municipal development program.

A. PLANNING/EDUCATION

Before the city embarks upon any sort of development program, it must first engage in careful planning to determine how it wants development to proceed within the city. The end result of the planning process should be a workable oil and gas ordinance designed to achieve goals identified in the planning process. The planning stage should also include procedures to educate the public on the city's goals and the methods it intends to use to achieve identified goals. The city should educate itself during the process. Consult operators in the area and see what problems they see in your proposed program. Consult other cities to see what problems they have encountered. Find out what local residents think about development and problems they associate with oil and gas operations.

Once the city has completed the planning process, and determined how it will regulate and promote development, it must attempt to educate the public on how the program will work, and how it will affect their interests. Once the city determines how it will regulate development, it is then prepared to "package" and "market" its oil and gas resources.

B. INVENTORY OF MUNICIPAL LANDS FOR DEVELOPMENT

Once the city decides to allow development, it will want to consider the development potential of the property it owns. This is accomplished by conducting an inventory of all real property interests the city owns and identifying, for each property, whether it could offer developers a lease or other development agreement on the property. In many cases, the city will be the largest single landowner in the city and will own single blocks of land which are attractive to developers. The city may own property near an area which is experiencing peripheral development which may be very interesting to operators attempting to follow the reservoir. During the inventory, the city should begin to identify property it may be interested in offering for development.

C. PACKAGING RESOURCES

When the inventory is complete, and the city has identified property it would like to lease, it is ready to begin "packaging" the lands for a lease sale. Packaging includes anything the city can do to make the lands attractive to developers. If there is adjacent or past production in the area, the city may want to obtain all available information concerning past or present production and future potential. Much of the information can be obtained from the Kansas Corporation Commission. However, in many cases a consulting geological or petroleum engineer may be required to adequately address such matters.

The city can take action to make preliminary title information available to prospective developers. Also, if artfully drafted, the city should be able to use their oil and gas ordinances as a critical selling point for the package. If the developer can clearly define its obligations for operations within the city, they will be more likely to undertake the substantial capital investment required to conduct operations.

As will be seen in Section VIII of this paper, the city can use its regulatory authority to create a very favorable development climate without sacrificing the public health, safety, or welfare. Time spent properly packaging lands for lease will, in most cases, be rewarded with greater income on lease offerings. Once the lands are packaged for offering, the next step will be the lease sale.

D. THE LEASE SALE

The lease sale can be used for many purposes. First, it can be used to offer lands for development under a competitive bidding system which should yield the city the best offer on its property. Second, and perhaps more important in an undeveloped "wildcat" area, the mere offering of lands may generate interest in the area and the property being offered.

To have a successful lease sale, the city must have conducted the required planning, inventory, and packaging beforehand. The city must also provide all bidders with detailed information concerning regulatory burdens on municipal development and lease terms. The city should prepare the proposed lease containing the terms it must obtain. Lease terms are discussed in detail in Section VI of this paper. The goal is to educate bidders so they know exactly under what conditions they will be required to operate. Any benefits which local regulation may offer the bidder should also be identified.

To more fully appreciate the lease sale process, consider the following sample ordinance and resolution:

ORDINANCE NO. 3562

AN ORDINANCE AUTHORIZING AND ESTABLISHING A PROCEDURE FOR THE SALE OF OIL AND GAS DEVELOPMENT CONTRACTS ON MUNICIPAL PROPERTY.

BE IT ORDAINED BY THE GOVERNING BODY OF THE CITY OF GUSHER, KANSAS:

SECTION 1. CONTRACTS FOR DEVELOPMENT AUTHORIZED.

The governing body is authorized to enter into contracts granting to developers the right to explore, produce, and do all things incident to the development of oil, gas and other minerals, from property owned by the City of Gusher. The decision to offer a particular tract of land for development, and the terms of the development contract, shall be determined by the governing body.

SECTION 2. RESOLUTION STATING METHOD OF OFFERING PROPERTY.

The governing body, by resolution, shall identify the property to be offered for development and specify the process by which the city will seek contracts to develop such property.

SECTION 3. CONTRACTS SIGNED BY MAYOR.

All leases or other contracts authorized by Section 1 shall be executed on behalf of the city by the mayor and attested to by the city clerk.

SECTION 4. EFFECTIVE DATE.

This ordinance shall take effct and be in force from and after its publication in the official city newspaper.

Passed by the commission the 5th day of May, 1983.

Signed by the mayor the 5th day of May, 1983.

_____
Mayor

ATTEST:

_____
City Clerk

RESOLUTION NO. 1

A RESOLUTION AUTHORIZING THE SALE OF OIL AND GAS LEASES ON MUNICIPAL PROPERTY.

BE IT RESOLVED BY THE GOVERNING BODY OF THE CITY OF GUSHER, KANSAS:

SECTION 1. AUTHORITY.

Pursuant to City of Gusher, Kansas Ordinance No. 3562, the governing body desires to lease lands belonging to the city for the exploration and production of oil and gas. The governing body, in compliance with Section 2 of Ordinance No. 3562, has made this resolution to identify the property offered for lease and to specify the terms, conditions, and method by which such leases will be offered for sale.

SECTION 2. LANDS.

The following property shall be offered for lease under the terms of this resolution:

> The North one-half (N½) of the
> Northwest quarter (NW¼) of the
> Southwest quarter (SW¼), Section
> Ten (10), Township Thirty-two (32),
> Range Seventeen (17) East, all in
> Montgomery County, Kansas

The described land is known as the "Fairview Cemetery" and is currently used for burial purposes.

SECTION 3. RESTRICTIONS.

All operations on the offered property shall be subjec to the zoning, oil and gas development, and other general ordinances of the City of Gusher, state and federal law, and the terms of the attached EXHIBIT A titled "Oil and Gas Lease."

SECTION 4. ZONING.

The offered property has been zoned to permit oil and gas operations, subject to the terms of the Oil and Gas Lease attached as EXHIBIT A to this resolution.

SECTION 5. BIDDING PROCEDURE.

The land described in Section 2 of this resolution shall be offered for sale by sealed bid. The governing body shall cause notice of the sale to be published in the local newspaper and in any other publication the governing body believes will reach interested bidders. The frequency and content of lease

sale notices shall be determined by the governing body. All bids should be in a sealed envelope addressed as follows: Bid-Oil and Gas Lease Sale #1, c/- City clerk, 200 Main Street, Gusher, Kansas 66763. All bids will be opened at a designated time in the City Hall Building, which time and place shall be described in all lease sale notices.

Each bid offer shall be accompained by a certified check or money order for the full amount of the lease bonus and first year rentals offered. The governing body shall promptly and in any event within three (3) business days following announcement of the successful bidder, return all checks or money orders submitted by unsuccessful bidders.

SECTION 6. BID ACCEPTANCE.

The governing body shall have the right to reject any or all bids or to accept any bid which may, in their view, be in the best interest of the City of Gusher. All bid notices shall indicate the governing body's authority to reject all bids and accept any bid it deems proper. The governing body shall have a period not to exceed fourteen (14) business days to review all bids and announce the successful bidder, or to reject all bids.

SECTION 7. BID PACKET.

The governing body shall cause a "bid packet" to be put together which contains a copy of the following documents:

(1) Ordinance No. 3562.
(2) Resolution No. 1
(3) Ordinance No. 1510 (Regulating oil and gas development).
(4) All applicable orders of the Kansas Corporation Commission affecting the land offered.
(5) Ordinance No. 3520 (Rezoning property for oil and gas development)
(6) Oil and Gas Lease.
(7) Bid Offer Sheet.
(8) Bid Evenlope.
(9) Bid Information Sheet.
(10) Bid Instruction Sheet.

Upon request, the city clerk shall provide each interested bidder with a bid packet. The availability of such bid packets shall be noted in all lease sale notices.

This resolution shall take effect upon its passage by the governing body.

Passed by the Commission the 10th day of May, 1983.

Signed by the mayor the 10th day of May, 1983.

Mayor

ATTEST:

City Clerk

Section 7 of the foregoing resolution should serve as a checklist for items to consider when planning a lease sale. The bid offer sheet should accompany the Oil and Gas Lease and the certified check or money order. The bil offer sheet may be arranged as follows:

BID OFFER SHEET

On this _____ day of _____, 198__,

_____
(name of person or entity making the bid)
located at _____,
(address of residence or principle place of business)
offers the following bid for a lease on the land described in City of Gusher Resolution No. 1 dated May 10, 1983, subject to the terms stated in Resolution No. 1 and in the Oil and Gas Lease attached to said resolution as Exhibit A:

BONUS: $_____.

ANNUAL RENTALS: $_____.

In the event this bid is accepted by the City of Gusher, bidder agrees to comply fully with all terms, conditions, and requirements specified in Resolution No. 1 and the referenced Oil and Gas Lease which has been executed by bidder and is being submitted with this bid offer sheet and a certified check or money order for the total bonus bid and the first year delay rental payment.

Bidder acknowledges the City has the right to reject any or all bids, or to accept any bid which may, in the sole discretion of the city governing body, be in the best interest of the City of Gusher.

_____
(authorized signature of bidder)

_____
(title)

The "Bid Information Sheet" should contain any relevant data pertaining to the offered lands. This also gives the city an opportunity to discuss development procedures within the city, address potential title questions, and draw specific attention to any beneficial aspects associated with the lands offered for development within the city. The information sheet can also be used to alert bidders to colateral requirements which may not be specified elsewhere in the bid packet. For example, in this case you may want to alert potential bidders to special requirements or statutes which will affect operations on the offered lands. For example, consider the situation created by Kansas Statutes Annotated Sec. 55-211a[57] and Sec. 12-1441.[58] Although a developer could work with Sec. 55-211a, Sec. 12-1441 would seem to prohibit surface use of cemetery lands which do not fall within the definition of "burial or other intended cemetery purposes".[59] The city will want to give bidders advance notice of the restrictions it intends to impose on the developer to comply with these statutory limitations. The appropriate technique for imposing any required special restrictions will be writing them into the oil and gas lease. Therefore, we next consider the basic document the city will use to govern the specific aspects of developing its lands -- the municipal oil and gas lease.

VI. THE MUNICIPAL OIL AND GAS LEASE

The major consideration when drafting an oil and gas lease for the city is to make it workable. Regardless of how interested a developer may be in certain property, if the lease offered makes operations impractical, the developer will spend their time, effort, and money elsewhere. However, this doesn't mean you have to give everything to the developer' you just have to ensure the lease will allow prudent operations to recover whatever oil and gas might be under the leased lands.

This Section will address basic lease terms. Special development contract terms will be considered in Section VII. The city will have to weigh its bargaining position in each case to determine what lease terms, or type of development contract, it will be able to require. For example, if the city is in an undeveloped "wildcat" area, it will be interested in terms which will encourage exploratory drilling. If successful development is occurring around the city, it may be in a position to insist upon terms which will maximize income to the city. The discussion which follows will address the variations in lease terms available to the city under wildcat and developing conditions.

A. PRELIMINARY INFORMATION/GRANTING CLAUSE

The first part of the lease should identify the document, the parties, and the affected lands. I prefer to have a "clean" form document and reference an exhibit for the information concerning the lessee and the lands being leased. Therefore, the first part of the lease would be as follows:

CITY OF GUSHER, KANSAS
OIL AND GAS LEASE

NO. _____
LEASE DATE _____

THIS LEASE is made between the City of Gusher, Kansas, hereinafter called "CITY", and the person or entity named in Part 1 of EXHIBIT A attached to this LEASE, hereinafter called LESSEE.

IN CONSIDERATION of the mutual promises made between CITY and LESSEE, and the payment of the annual rentals and royalties provided for in this LEASE, CITY grants, demises, leases, and lets exclusively to LESSEE, for the sole purpose of mining and operating for oil and gas, and the building or laying of tanks and other structures necessary for the production, handling, and removal of oil and gas produced from this LEASE, all the lands described in Part 2 of EXHIBIT A, subject to the following terms and conditions.

Note that this part of the lease also contains the "granting clause" which gives lessee the right to mine oil and gas from the land and to erect tanks or other structures necessary for conducting oil and gas operations.[60] However, the lease grant is made subject to thelease terms which follow.

B. LEASE DURATION/DELAY RENTALS

The duration of the lease will usually be stated as a set "primary term" subject to extension by operation of a "habendum clause". The lease duration will also be affected by othe contingencies specified in the lease which may cause the lease to terminate, or be extended. The primary term is usually stated as a specified number of years. The habendum clause extends the lease beyond the stated primary term when a stated event occurs, such as production of oil or gas in paying quantities. A typical lease would provide:

1. LEASE DURATION. This LEASE shall remain in force for a Primary Term of _____ years from the Lease Date indicated above, and so long thereafter as oil or gas is produced from the leased premises in paying quantities, unless otherwise terminated or extended by other provisions of this LEASE.

The length of the primary term is often dictated by the type of activity in the area. If producing wells are already in the immediate area, a short primary term of one or two years may be sufficient. If the area constitutes wildcat acreage, a longer primary term may be required to attract a lessee. However, the primary term is often limited by other clauses requiring wells to be drilled within a certain period of time to prevent a lessee from acquiring acreage solely for speculation. It is also customary to make the lessee pay delay rentals for the privilege of holding the lease without engaging in its active development. A sample delay rentals cause follows:

2. DELAY RENTALS. This LEASE shall terminate one year from the Lease Date unless, on or before said date, either: (1) operations for the drilling of a well for oil and gas on thel eased premises have commenced and are being diligently pursued, or (2) LESSEE pays to CITY the sum of _____ Dollars ($ _____) as a rental which shall extend for one year from the Lease Date the time within which drilling operationsmay be commenced. In the event a well is completed as a dry hole during the Primary Term, or production from a well ceases during the Primary Term, LESSEE can pay the delay rental provided for by this Section and extend the lease the same as if no well had been commenced during the rental period. Upon payment of rentals in like manner and amount on or before the extended Lease Date, the time for commencing

drilling operations can be further delayed for successive periods of one year each, but in no event shall any rental payment extend this LEASE beyond the Primary Term.

C. ROYALTY

The major consideration for most landowners in entering into an oil and gas lease is the expectation of royalty income. Royalty is usually expressed as a fraction or percentage of all oil and gas produced and saved from the lease or lands with which the lease is pooled or unitized. A typical royalty clause provides:

3. ROYALTY. Each month, LESSEE shall remit to CITY, out of production from or attributable to the leased premises, the following royalties to be paid and delivered free of all development, production, storage, treatment, and transportation costs:

a. On oil and other liquid hydrocarbons, _____ percent (_____%) of the Market Value of that produced and saved from the leased premises, or at the CITY's election, LESSEE shall deliver said royalty to CITY in kind in the lease tanks or into pipelines to which wells on the leased premises may be connected.

b. On gas, casinghead gas, and other gaseous hydrocarbons, and any product made from such substances, _____ (_____%) of the Market Value of that produced and saved from the leased premises.

"Market Value", for the purposes of this Section, shall mean the LESSEE's sales price for the oil, gas, or products; Provided, that if production is sold to affiliates of LESSEE, or is used by LESSEE off the LEASE premises, the "Market Value" for such production shall be fixed at the highest lawful market price available in the area for substances of like kind, grade, and quantity.

All royalties shall be due and payable no later than ninety (90) days after first production and thereafter no later than fifteen (15) days following the month in which settlement was made with the purchaser or purchasers of production. Where production is used off the leased premises by LESSEE, payment of royalties shall be made within fifteen (15) days following the month of production.

Depending upon the situation in each locality, and the quality of production, the royalty clause may have to be revised to provide for transportation costs and processing costs incurred by the lessee. The local situation can be ascertained by talking with operators and purchasers in the area.

Even though the lessee drills a well capable of production, it may not be able to find a market for such production. This is often the case with natural gas. Unlike oil, gas cannot be economically placed in a tank and hauled to a market. Instead, gas

requires an extensive capital investment in a pipeline to carry it to the ultimate purchaser. In many cases, it may be years before a field is sufficiently developed to justify the expense of building a pipeline. During this period, the lessee has a well capable of production, but unable to produce. The habendum clause provides thelease will be extended beyond the primary term "so long . . . as oil or gas is produced from the leased premises in paying quantities". Since the well cannot be "produced" for lack of a purchaser, the lessee will require the lease to provide for this contingency in the form of a Shut-in Gas Royalty Clause. A sample clause follows:

> 4. SHUT-IN GAS ROYALTY. On a well or wells capable of producing gas only in paying quantities or having a gas-oil ration such that the well cannot be operated without the use or sale of gas, and gas is not being used off the premises or marketed therefrom, and this LEASE is not then being maintained by other production or drilling operations, this LEASE shall nevertheless remain in full force and effect for a period of sixty (60) days after production or oeprations cease if LESSEE gives CITY written notice of the date production or operations cease and, on or before the expiration of said sixty-day period, pays to CITY a sum equal to the annual rental specified in Section 2 of this LEASE or _____ Dollars ($_____) per well, whichever is greater. Such payment shall be in lieu of rentals and shall maintain the LEASE in full force and effect for a period of six (6) months from the expiration of said sixty-day period. Thereafter, semiannually in like manner, at six-month intervals from the expiration of salie sixty-day period, upon like payments, this LEASE will continue in force and effect for successive periods of six (6) months each so long as such payments are made, but not, however, exceeding _____ (_____) such successive periods beyond the Primary Term of the lease. So long as such payments are made, it shall be considered that gas is being produced under the lease in paying quantities and such payments shall have the same effect as the production of gas for all purposes of the LEASE. Such payments shall be deemed royalty payments and shall be distributed to those entitled to royalties from the leased acreage.

Another contingency the developer will want to provide for is extension of the lease when production ceases, a dry hole is completed, or drilling or other development operations are being diligently pursued.

D. DRILLING OPERATIONS/CITY'S TITLE

The developer will require provisions in the lease to protect its interests in the event (1) a well is completed as a dry hole after the primary lease term has expired or (2) operations initiated during the primary term have not been completed but are being actively pursued at the expiration of the primary term. A sample clause follows:

> 5. DRILLING OPERATIONS. If, at the expiration of the Primary Term of this LEASE, oil or gas is not being produced from the LEASE premises, but LESSEE is engaged in drilling or reworking operations thereon, then this LEASE shall continue in force so long as drilling or reworking operations are being continuously conducted on the LEASE or on a drilling unit which includes all or a part of this LEASE. Drilling or reworking operations shall be

considered to be continuously conducted if not more than sixty (60) days shall elapse between the completion or abandonment of one well and the beginning of operations for the drilling or reworking of another well. If oil or gas shall be discovered and/or produced from any such well or wells drilled, being drilled or reworked at or after the expiration of the Primary Term of this LEASE, this LEASE shall continue in force so long as oil or gas is produced from the leased premises or from any drilling unit to the extent it includes lands covered by this LEASE.

Another contingency the developer will want addressed in the lease are events, beyond the developer's control, which could prevent performance of lease obligations. Such contingencies are commonly referred to as "force majeure".

6. FORCE MAJEURE. This LEASE shall not be terminated, nor shall LESSEE be held liable in damages for failure to comply with the express and implied covenants hereof, if compliance is prevented by, or if such failure is a result of, any Federal or State laws, executive orders, rules, or regulations, or any other cause beyond the reasonable control of LESSEE. However, it shall be incumbent upon LESSEE to give CITY prompt written notice of the existence of a claimed force majeure. The LESSEE shall, in any event, be required to proceed with due diligence to remove the force majeure. If, at the end of the Primary Term, this LEASE has not been extended by production or drilling as hereinabove provided and LESSEE, by reason of any of the above causes, is unable to drill a well on leased premises, the Primary Term and the rental provisions of this LEASE shall automatically be extended from year to year up to and including, but not beyond, the first rental period occurring ninety (90) or more days after the removal of such delaying cause.

Sections 4, 5, and 6 of the sample lease provide for contingencies where the lessee is unable to perform. The operator will also want a provision to account for the City's lack of title.

7. CITY'S TITLE. To the extent CITY owns a lesser interest in the leased land than the entire and undivided fee simple estate, the royalties and rentals herein provided shall be paid to the CITY only in the proportion which its interest bears to the whole and undivided fee.

CITY makes no warranty of its title to the described land but agrees that in the event the failure of CITY's title be finally determined by a court of record and in consequence thereof LESSEE is required to account to third parties for oil or gas produced from the CITY's land, CITY shall reimburse LESSEE, without interest, for rentals, royalties and bonuses paid to CITY in respect to the acreage or interest to which CITY's title may fail.

E. POOLING/ASSIGNMENT/DEFAULT.

In Kansas, the lessee will always want a pooling clause in their lease to provide for the consolidation of interests into drilling or proration units. This is especially important since Kansas does not have statutory pooling provisions. However, the lease form being used in this example contemplates the City of Gusher is taking an "active" approach to oil and gas development and therefore has enacted a compulsory pooling ordinance.

8. POOLING. All or any part of this LEASE may be pooled with other lands to form drilling units pursuant to the Ordinances of the City of Gusher, the laws of Kansas. Operations on or production from a well located on any lands included in such drilling unit shall serve to maintain this LEASE in force as to that portion of the leased premies included in or attributed to such drilling unit, but shall not maintain, beyond the Primary Term of this lease, any leased lands outside such drilling unit, unless otherwise extended by the terms of this LEASE.

Note the "Pugh Clause" drafted into the pooling provision. Such a clause is used to prevent the lessee from holding an entire piece of acreage while the lessor only receives income based on a smaller portion committed to the drilling unit. Note, however, the clause in this example operates only after the primary term of the lease. In the municipal development situation, if the area concerned has been spaced in a reasonable manner, the Pugh Clause should not be objectionable to the lessee, especially since it operates only after the primary term has expired.

Another provision of interest to the developer is the assignment clause. The lessee will want the ability to readily assign interests in the lease, especially where it is relying on direct investor capital for development. However, the City should be careful and control some aspects of assignment to prevent, to the extent possible, the lessee from escaping responsiblity under the lease. A suggested provision follows:

9. ASSIGNMENT. Either party may assign any interest in this LEASE without enlarging the existing obligations of either CITY ore LESSEE under this LEASE. Howeve, before any assignment of a working interest by LESSEE can be effective, LESSEE must give CITY written notice of the proposed assignment and a description of the proposed assignee, and obtain the written consent of the CITY to the proposed assignment. CITY shall readily give its consent to any assignment so long as LESSEE is currently in compliance with all lease terms, or the CITY elects to waive lease obligations to permit assignment to the designated assignee. LESSEE shall not be released from its obligations under this LEASE until its assignee has obtained all required permits, bonds, insurance, and otherwise completed the necessary requirements to assume responsibility for the interest being assigned.

The city should also provide for a clause stating what will happen if th LESSEE fails to comply with its lease obligations to the city. Consider the following:

10. DEFAULT. If LESSEE fails to keep or perform any LEASE term, condition, stipulation, or other convenant, express or implied, with which it is obligated to comply, CITY shall have the option to terminate this LEASE. Provided, CITY shall be required to give LESSEE written notice identifying the breach and provide LESSEE with thirty (30) days from the date such notice is received to remedy the breach. Provided, however, as to the breach of an implied covenant, LESSEE shall have sixty (60) days from the date such notice is received to remedy the breach.

F. ORDINANCES/STIPULATIONS

The primary provisions in the lease which will protect the city and its inhabitants from the potential negative effects of development are the "Applicable Law" and "Special Lease Stipulations" sections of the lease. The first clause, titled "Applicable Law", incorporates the oil and gas development, zoning, environmental control, and all other city ordinances which may relate to oil and gas activities. State and federal laws are similarly incorporated. A simple clause follows:

> 11. APPLICABLE LAW. LESSEE shall comply with all applicable law, rules, and regulations which were effective as of the Lease Date. LESSEE shall comply with all applicable laws, rules, and regulations which may, from time to time, be adopted and which do not impair the obligations of this contract nor deprive LESSEE of an existing property right recognized by law.

Obviously, the city must have its major oil and gas regulatory ordinances in place and effective before the lease is signed.

The next provision, titled "Special Lease Stipulations", gives the city an opportunity to write in site specific restrictions which pertain to the specific lands being leased. In the cemetery example, the city would want to add a stipulation prohibiting any surface occupancy of the leased lands. Arguably, such a stipulation is necessitated by Kansas Statutes Annotated Sec. 12-1441.[61] A sample lease stipulation clause follows:

> 12. SPECIAL LEASE STIPULATIONS. In addition to the other provisions of this LEASE, LESSEE shall comply with all special lease stipulations listed in Part 3 of EXHIBIT A.

G. BINDING EFFECT/SIGNATURES

The last portions of the lease are similar to that of most contracts affecting real property. Sample clauses follow:

> 13. BINDING EFFECT. This LEASE, and all its terms, conditions, and stipulations, shall extend to and be binding on the successors and assigns of CITY and LESSEE.

SIGNED to take effect as of the Lease Date.

CITY	LESSEE
By_____	By_____
Mayor	LESSEE TITLE

ATTEST:

_____
CITY CLERK

ACKNOWLEDGMENT

(appropriate acknowledgment form for each party)

We are now ready to consider various techniques the city can employ to maximize their possible gain in oil and gas operations.

VII. MAXIMIZING MUNICIPAL INCOME FROM OIL AND GAS DEVELOPMENT

Depending upon the intensity of development activity in the immediate area, the ciy may be in a position to obtain more than merely the standard royalty or rentals customarily offered by developers. If the city has, in the past, prohibited or severely limited development, it may be sitting on highly desirable acreage. In such cases, it may be able to demand a better deal without discouraging developers. In the sections that follow, I will discuss special lease provisions and development agreements the city may want to consider.

A. SPECIAL LEASE TERMS

In Section VI. the "basic" lease terms were examined. In this section some additional lease terms are identified which the city may want to consider. In addition to negotiating lease bonus, rental, and royalty provisions, the city may attempt to specify the lessee's development obligations. This is normally accomplished through a "development" or "continuous development clause" which requires the lessee to drill the lease to a stated well density within a specified time or give up the portions of the leased lands which are not developed. For example, suppose you have a ten-acre lease which, under the applicable spacing rules, could be divided into four drilling units of 2.5 acres each. The following clause might be used to require development of the lease to its maximum density in a stated period of time:

> CONTINUOUS DEVELOPMENT. LESSEE shall drill and complete a well on each drilling unit within the leased premises with the first well to be commenced not later than six (6) months from the Lease Date and thereafter LESSEE shall commence a subsequent well within one hundred twenty (120) days of completing the previous well until all designated drilling units on the leased premises have at least one well producing in paying quantities. If LESSEE fails to commence the initial well or any subsequent well within the stated time period, this LEASE, at the CITY's option, shall terminate as to all drilling units within the leased premises which do not currently have a well producing in paying quantities. All operations commenced by LESSEE pursuant to this Section shall be diligently conducted.

The city may also desire to limit lessee's rights to only those depths the lessee has drilled. For example, in the granting clause, the city could provide:

This grant is limited to cover only formations above and including the deepest formation tested by any well during the Primary Term, or commenced before the end of the Primary Term and completed thereafter in compliance with the terms of this LEASE. LESSEE agrees on demand to execute and record such instruments as necessary to establish of record such deeper section or sections as do not continue subject to this LEASE.

The city may want to consider using a sliding scale royalty which increases as production increases. For example, the city could require a 12.5% royalty on the first twenty-five (25) barrels of oil sold during any calendar month with an increased royalty of 18.75% on the next twenty-five (25) barrels of oil sold, etc. Interest on royalties not paid in a timely manner may also be required. Many states, by statute, specify when royalties must be paid and provide for interest and penalties for late payment. Kansas does not have legislation addressing royalty payment.

The city may require lessee to provide information to allow the city to verify it is receiving a fair price on production from which royalties are calculated. Some lessors even require access to all processed data from seismic, exploration, and drilling operations on the leased lands.

Many other types of lease provisions can be used; the city is only limited by the imagination of its city attorney and governing body. However, in most cases the practical limitation will be finding a lessee willing to accept your terms. Once again, this will depend upon the value of the acreage and the willingness of the lessee to make special concessions to obtain such acreage. Also, with the municipal oil and gas lease, many subjects otherwise addressed by lease terms will be covered by specific ordinances. Such matters as bonding, insurance, surface damages, operation requirements, and reclamation should normally be addressed by a general ordinance which is then incorporated into the lease under the "Applicable Law" clause.[62]

The city may want to consider alternatives to the oil and gas lease for developing its lands. The basic development contract the city could use is the "Farmout Agreement".

B. FARMOUT AGREEMENT

Instead of merely retaining a royalty interest in development, the city may want to have the opportunity to obtain a working interest and operate the developed lease jointly with the developer. This can be done by the city "farming out" acreage to the developer. Normally the developer will not pay any bonus or rentals, but instead will be required to commence a well within a stated period of time. If the well produces in paying quantities, the "farmee" (developer) will "earn" a stated percentage in the drill site acreage and, in some cases, acreage outside the drill site.

The city will retain a royalty interest in the drill site until the well "pays out". Pay out is a defined event which usually includes the developer's recovery, from its share of production, less taxes, an amount equal to the cost of drilling, testing, completing, and equipping the well, plus operating expenses prior to payout. At payout, the city will have the option to convert its royalty interest to a stated working interest. Subsequent operations would thereafter be conducted under the terms of a joint operating agreement.

The benefit to the city will be the prospect of greater income from the well. Even if the city electes not to join in joint operations, it may want to convert its royalty interest to the larger working interest and then sell the working interest. A royalty interest is not charged for operating or development costs. A working interest is charged costs in the proportion each working interest bears to the entire working interest in the well. Therefore, the city may want to make special provisions in the joint operating agreement to have all its costs taken only from its share of production proceeds realized from the well. Otherwise, the city may be required to budget funds to cover its share of costs in joint operations.[63]

Once the city has decided to actively pursue the development of oil and gas, it must develop a regulatory regime that will permit development without adversely affecting the public health, safety, and welfare. The following section examines oil and gas regulation and indicates what the city can do to effect orderly development.

VIII. REGULATIONS OF OIL AND GAS DEVELOPMENT

Before considering the city's authority to regulate oil and gas operations, it is necessary to consider the problems associated with the development of oil and gas.

A. NATURE OF THE ACTIVITY

Oil and gas exploration and production require land uses which often conflict with surrounding land use. Land alteration with earth moving equipment is necessary to prepare a drilling site and create pits for drilling fluid circulation. Access to the drill site requires roads for moving heavy equipment.

Once a drilling rig is on site the operator, due to rental expenses, will want to drill on twenty-four hour a day schedule. When the well is completed a pumping unit is installed and storage tanks brought on site whenever pipeline transportation is not available. Open-top water separation tanks are common at many site. Large trucks will be moving in and out of the area throughout the life of the well to haul petroleum production.

The simple oil well can, through development and production, create many adverse impacts for surrounding land owners. If close to residential housing it may create aesthetic, noise, odor, traffic, and safety problems. If the well is unproductive, or ceases to produce, abandonment of the site without proper reclamation may adversely impact surrounding properties.

Aside from the physical effects, permitting a well may create property righs problems for other land owners in the area. If you permit a lessee to drill in one area but not another, there are possible claims by owners of the undeveloped properties that their correlative rights are being violated.[64] Local governments have taken widely varying roles as to the extent they will attempt to marshal private interests in the resource.[65]

In all instances where the local government is actively involved in regulating oil and gas development, it must take action to prevent potential tort liability it may incur for failure to properly direct and police permitted operations.[66] Developer performance

insurance and bonding requirements are routinely imposed to protect the local entity and to insure the financial responsibility of the developer.[67] To understand the regulatory measures local governments have taken, and the judicial and legislative responses thereto, we next examine some specific local regulatory approaches.

B. REGULATORY APPROACHES

Local governments can use one of three general approaches to regulate oil and gas exploration and production. The local entity can prohibit any oil and gas activity within its political boundaries when reasonably related to protecting the public health, safety, and welfare.[68] Secondly, oil and gas activity can be prohibited in some areas and permitted in others pursuant to a zoning ordinance.[69] A third approach is to regulate the activity directly by local law specifying permit, operation, bonding, insurance, reclamation and other requirements.[70] The direct regulatory approach may be used in addition to or in lieu of the zoning approach.[71]

Regardless of the approach used by a local government, it must be able to justify the regulation as a legitimate use of its police power to protect the public health, safety, and welfare.[72] Courts generally give great deference to a local government's perceived need for regulation to promote and protect public interests.[73] However, local entity abuse of its broad powers may result in retaliatory state and federal legislation to restrict local regulation of vital energy resources.[74]

Direct local regulation can be divided into three general categories: taxation, public protection, and allocation of rights in the resource. Public protection is the easiest to justify under the police power.[75] Local power to allocate rights in the resource is derived, less directly, from the police power. Ordinance provisions establishing minimum royalty payments and other lease requirements are included in the allocation of rights category.[76] Taxation of the resource will occur pursuant to express state constitutional or statutory delegation of the taxing power to the entity.[77]

Nearly all aspects of oil and gas development are subject to local regulation. However, regulation may be substantially restricted in some states depending on the extent local entities are delegated authority to act. Many times the courts will determine whether grants of local authority are to be strictly or liberally construed.[78]

Cities and counties generally have the power to regulate where drilling will occur,[79] production practices,[80] postproduction practices,[81] pooling of interests within the city or county, [82] permit and inspection fees,[83] bond requirements,[84] insurance requirements,[85] traffic flow,[86] and other aspects of the activity which may adversely impact the local community.[87] However, when regulating mineral extraction, additional care must be taken by the governmental entity to justify its action as a legitimate exercise of the police power. If you want to locate a mobile home in a certain place, but are prohibited by existing zoning laws you merely place it in another zone or outside the corporate limits. Unlike the mobile home, the mineral developer cannot move a geological structure.[88] Courts will therefore take a closer look at the local regulation to determine if it is reasonably related to protecting the public health, safety, and welfare.[89] In Michigan, for example, the courts will uphold zoning regulations which prevent the extraction of natural resources only when "very serious consequences" will result from the proposed extraction.[90]

C. SPECIFIC MATTERS TO ADDRESS IN OIL AND GAS REGULATIONS

Following is a list of some of the specific matters a city may want to consider when drafting ordinances regulating oil and gas activities.

1. ACTIVITIES RESTRICTED

The city's oil and gas ordinance should be broad enough to cover all activities relating to oil and gas operations. Mere references to oil and gas "drilling" are not sufficient. I would suggest using the following phrase: "drilling, reworking, deepening, plugging back, repressuring, or otherwise conducting operations on property for the exploration or production of oil or gas". The standard approach is to prohibit all such activity unless a permit is obtained and all operations are conducted pursuant to the terms of the ordinance. Consider the following:

> OPERATIONS RESTRICTED. The drilling, reworking, deepending, plugging back, repressuring, or other operations for the exploration or production of oil, gas, or similar substances, within the City of Gusher, Kansas, is unlawful, except as provided by the subsequent provisions of this ordinance.

This provision is normally followed by a permit section which sets out the application fees, permit procedure, and special permit requirements. The permit application is usually accompained by information indicating the proposed location of well sites and proof the developer has the legal right to enter and conduct operations on the well site acreage.

2. DRILLING UNITS

In light of the lack of adequate statutory pooling provisions in Kansas, and the existence of case law which requires a lessee to excessively develop lands in order to comply with the implied covenants to develop and protest against drainage,[91] it is imperative that cities consider spacing acreage available for development within the city into drilling units. Such an ordinance should provide for the automatic pooling of separately owned acreage located within each drilling unit.

The easiest approach is to identify areas within the city's jurisdiction which can be developed and designate a logical spacing pattern for all lands within the development area. When considering a spacing pattern, applicable orders of the Kansas Corporation Commission (K.C.C.) should be examined. The city should coordinate its efforts with the K.C.C. and obtain advice from its personnel concerning the proposed spacing program. In many counties and areas the K.C.C. has, by order, adopted special well set back rules. If the city's proposed spacing plan does not coincide with the K.C.C. rule in effect, the city should request a hearing before the K.C.C. to present its program and attempt to obtain a special order adopting the city's spacing program. The overriding consideration of the K.C.C. will be to prevent "waste" and protect correlative rights. If the city goes to the effort to get an area spaced, it will make it easier for the developer since it will not be required to go before the K.C.C. for a special exception for each well drilled within the city.

Once the city has divided the target area into designated drilling units, it must limit development to one well per drilling unit. All land and interest owners within a drilling unit should be permitted to share in production from the unit well in the proportion their respective interest bears to all interests encompassed by the drilling unit. This is usually done on a square footage basis. The process can be more fully appreciated by considering the following sample clause:

> DRILLING UNITS. The city shall designate drilling units which shall consist of the maximum area which the city, in its discretion, determines can be orderly developed by a single well so as not to cause waste or interfere with correlative rights or the public health, safety, and welfare. All wells located within the city's jursidiction shall be located on a designated drilling unit. There shall be no more than one well in a single drilling unit producing from the same formation.
>
> POOLING. All separately owned tracts of land, or interests in such land, embraced within a city-designated drilling unit, are hereby pooled for the purpose of oil and gas development. All operations for oil or gas within the drilling unit shall be deemed for all purposes to have been conducted upon each tract within the drilling unit by the owner(s) of such tract. For the purposes of determining the portions of production owned by the persons owning interests in the pooled oil or gas, such production shall be allocated to the respective tracts within the unit in the proportion the surface square footage included within each tract bears to the surface square footage included in the entire unit. The portion of the production allocated to the owner(s) of each tract or interest included in a drilling unit pursuant to this section, when produced, shall be considered as if produced from the separately owned tract or interest by a well drilled on such tract.
>
> If the interest of any owner(s) of any unleased mineral interest is pooled by virtue of this section, seven-eights of such interests shall be considered a working interest and one-eighth shall be considered a royalty interest, and such owner(s) shall, in any event, be paid a cost free one-eighth of all production from the unit creditable to their proportionate interest.
>
> Any owner(s) may pay thier proportionate share of costs, in advance, for the development andoperation of a well on the drilling unit. Such costs shall be limited to the actual expenditures for such purpose and, in any event, shall not exceed what are reasonable costs. However, such costs shall include a reasonable charge for supervision. If any owner(s) elect not to pay their proportionate share of costs in advance, the owner(s) paying costs in advance shall be entitled to a pro rata reimbursement, solely out of production from the well, for their costs in drilling and completing the well. However, in addition to the costs provided for by this section, the owner(s) paying costs in advance may charge, as a cost for the risk involved in the drilling of such well, up to three hundred percent of the nonconsenting working interest owner(s)' pro rata share of the cost of drilling and completing the well.

Once the city has established the ground rules for development, its next task will be to address specific operation requirements such as fencing well sites, drilling time,

abandoning wells, site reclamation, etc. To ensure the operator is able to perform its obligations under applicable ordinances, a performance bond should be obtained to secure the interests of the city and its inhabitants. Similarly, the ordinance should provide for liability insurance. Confer with your local insurance representatives to see what protection is readily available.

The city will also want to address how oil and gas will be treated under its zoning laws. The preferable approach would be to allow oil and gas operations in all zones of the city when the operator has obtained the required permits.[92] The public health, safety, and welfare could be evaluated and considered as part of the oil and gas well permitting process. This would eliminate the need to obtain a zoning change or special use permit for each well. Likewise, the specific oil and gas permit should eliminate the need for any sort of building permit. Existing zoning ordinances should be examined to determine whether they need to be amended to accommodate this type of a one-step permitting process.[93]

The city should retain the authority, in its oil and gas permit, to make special requirements, in addition to those contained in the oil and gas ordinance, when the governing body deems it necessary for the protection of persons or property within the city's jurisdiction. This will give the city flexibility to deal with special situations that may arise which are not adequately addressed by specific provisions of the ordinance.

XI. CONCLUSIONS

The city attorney will find that oil and gas activities within the city create a number of unique legal problems which will require workable, practical solutions. For example, when the city elects to develop municipal property, whether it be streets, alleys, parks, or cemeteries, a number of title problems will immediately confront the city attorney. Don't rely on the developer to sort out these problems. Before you offer park lands for development, you need to ascertain whether the grant to the city will permit oil and gas activities.[94] Title to oil and gas beneath streets and alleys, depending upon how the land on which they are located was acquired, may belong to the county, city, or the original grantor.[95] The title source for the property must be consulted along with applicable statutes and case law to determine the city's interest.

The city must also consider its new exposure to tort liability and take whatever action it can to limit its risk. However, the city should not be timid in its implementation of new development or regulatory approaches.

Other problems will inevitably arise as development progresses. However, the city should not avoid development of its resources merely because it may require regulatory attention. Many problems can be anticipated and avoided through careful drafting of the basic oil and gas development ordinance. I would strongly urge the City Attorneys Association of Kansas to consider forming a special committee, comprised of city attorneys, to jointly evaluate problems and benefits associated with oil and gas development. Such a joint effort, utilizing the collective experience of the committee members, could aid cities in Kansas by offering suggested approaches to municipal oil and gas development and regulation. Such a committee could aid all city attorneys by compiling suggested model ordinances, lease forms, and other documents associated with the municipal oil and gas development process.

Cities in Kansas, perhaps more than any other municipal entity in the United States, are vested with very broad powers to determine and pursue their own destiny. Hopefully this paper will aid your efforts in exercising such powers to expand the economic resources available to the city, and the natural resources available to our nation.

FOOTNOTES

1. Interstate Oil Compact Commission, Oil And Gas Production 15-16 (1951) (hereinafter cited as Oil and Gas Production).

2. Id. at 16.

3. American Institute of Mining and Metallurgical Engineers, Petroleum Conservation 71 (1951) (hereinafter cited as Petroleum Conservation).

4. A. Levorsen, Geology of Petroleum 152 (2d ed. 1967) (hereinafter cited as Geology of Petroleum).

5. Oil and Gas Production, supra note 1., at 22-24.

6. Id. at 22.

7. A hole must be bored into the reservoir rock to release reservoir pressure. It provides a connection between the high-pressure oil reservoir and the low pressure existing at the earth's surface. The pressure release causes a pressure gradient within the reservoir toward the bottom of a well bore. Natural energy sources become active and move oil into the well bore, whence it is brought to the surface either through natural energy or by means of artifical lift. Oil and Gas Production, supra note 1 at 36.

8. See generally Geology of Petroleum, supra note 4, at 458-59.

9. Petroleum Conservation, supra note 3, at 120-22.

10. State v. Pennsylvania Railroad Company, 278 A.2d 587, 498 (Del. 1967).

11. "The term land was nomien generalissium including not only the face of the earth but everything under it. Cujus est solum, ejus est usque ad infernos." Toth v. Bigelow, 1 N.J. 399, 404, 64 A.2d 62, 64 (1849).

"It is ancient doctrine that at common law ownership of the land extended to the periphery of the universe -- cujus est solum ejus est usque ad coelum." United States v. Causby, 328 U.S. 256, 260-61 (1946).

12. Blackstone's quote was relied upon by the Montana Supreme Court in Gas Products Co. v. Rankin, 63 Mont. 372, 207 P. 993, 997 (1922), to strike down a state statute prohibiting the use of natural gas for the manufacture of carbon black. The Montana court specifically noted the opposite conclusion reached by the United States Supreme Court in Walls v. Midland Carbon Co., 254 U.S. 300 (1920), but held it was not bound by the Walls decision because it was applying Montana property law and the provisions of the Montana Constitution.

13. 155 U.S. 665 (1895).

14. Brown v. Spilman, 155 U.S. 665, 669-70 (1895).

15. The Supreme Court's use of an ownership in place theory was probably in recognition of West Virginai law treating oil and gas as solid minerals. Williams v. Jones, 39 W. Va. 231, 19 S.E. 436 (1894).

16. 177 U.S. 190 (1900).

17. Ohio Oil Co. v. Indiana, 177 U.S. 190, 208 (1900).

18. The non-ownership theory has also been called the "exclusive-right-to-take theory". 1 E. Kuntz, A Treatise On The Law of Oil And Gas 66 (1962). (hereinafter cited as 1 Kuntz).

19. Brown v. Spilman, 155 U.S. 665, 670 (1895).

The Court in Ohio Oil Co. v. Indiana, 177 U.S. 190 (1900), cited Bown v. Spilman as being in accord with the Indian approach. 177 U.S. at 205. The two theories are similar to the extent property rights in oil and gas can be lost through legitimate drainage under the rule of capture. However, the basic ownership concepts are different.

20. R. Hemingway, The Law of Oil And Gas 13, n.71 (1971) (hereinafter cited as Hemingway).

Qualified ownership concepts were used by some states to rationalize the recognition of correlative rights of landowners over a common oil or gas reservoir. Treating oil and gas as part of theland made application of correlative rights restrictions conceptually sound. Providing that the property interest was lost upon migration to another person's tract helped to account for the rule of capture.

1 H. Williams & C. Meyers, Oil And Gas Law 41-43 (1981) (hereinafter cited as 1 Williams & Meyers) places Oklahoma in the qualified ownership category.

21. 1 Williams & Meyers, supra note 20, at 46.

22. 145 Kan. 88, 64 P.2d 56 (1937).

23. Richards v. Shearer, 145 Kan. 88, 64 P.2d 56, 58 (1937). See also Kumberg v. Kumberg, 659 P.2d 823, 830 (Kan. 1983) where the Kansas Supreme Court states "(a) mineral interest refers to oil and gas in place. It is a real property interest."

24. In Barnard v. Monogahela Natural Gas Co., 216 Pa. 362, 365, 65 A. 801, 802 (1907), the Pennsylvania Supreme Court, considering oil and gas ownership rights, candidly explained its adoption of the rule of capture as a rule of necessity noting:

> Exact Knowledge on this subject is not at present obtainable . . . . This may not be the best rule; but neither the Legislature nor our highest court has given us any better. No doubt many thousands of dollars have been expended 'in protecting line's in oil and gas territory that would not have been expended if some rule had existed by which it could have been avoided.

25. E.g., Hail v. Reed, 54 Ky. 383 (1854).

26. Westmoreland & C. Natural Gas Co. v. DeWitt, 130 Pa. 234, 18 A. 724 (1889).

27. Higgins Oil & Fuel Co. v. Guaranty Oil Co., 145 La. 233, 82 So. 206 (1919).

28. See Brown v. Spilman, 155 U.S. 665 (1895).

29. Barnard v. Monogahela Natural Gas Co., 216 Pa. 362, 365, 65 A. 801, 802 (1907).

30. Kuntz, Correlative Rights in Oil and Gas, 30 Miss. L.J. 1, 2 (1958). See also, 1 Kuntz, supra note 18 at Sec. 4.3; Kuntz, Correlative Rights of Parties Owning Interests In a Common Source Of Supply Of Oil Or Gas, 17th Ann. Inst. on Oil & Gas L. & Tax. 217 (1966).

31. Temporary Admin. Reg. Sec. 82-3-101 (14) (Dec. 8, 1982), as printed in 1 Kansas Register, No. 51, December 23, 1982, at 1351, col. 2 (hereinafter abbreviated 1 Kan. Reg. page number).

32. Kan. Stat. Ann. Sec. 55-603 (1976).

33. Id.

34. Kan. Stat. Ann. Sec. 55-703 (Supp. 1982).

35. See generally Marrs v. City of Oxford, 32 F.2d 134 (8th Cir. 1929), cert denied 280 U.S. 573, 50 Sup. Ct. 29, 74 L.Ed. 625 (1929). See also Marrs v.City of Oxford, 24 F.2d 541 (D. Kan. 1928). (Same case at District Court level) and Helmerich & Payne v. Roxana Petroleum Corp., 136 Kan. 254, 14 P.2d 663 (1932).

36. Kan. Stat. Ann. Sec. 55-603 (1976); Kan. Stat. Ann. Sec 55-703 (Supp. 1982); Cities Service Oil Co. v. State Corporation Com'n, 207 Kan. 43, 483 P.2d 1123, 1128 (1971).

37. Id. See also Colorado Interstate Gas Co. v. State Corp. Com'n, 192 Kan. 2, 386 P2d 266, 284-85 (1963).

38. Temproary Admin. Reg. Sec. 82-3-108 (Dec. 8, 1982), 1 Kan. Reg. 1355.

39. Kan. Stat. Ann. Sec. 55-604 (C) (c) (1976) (oil); Kan. Stat. Ann. Sec. 55-703a (1976) (gas); Temporary Admin. Reg. Sec. 82-3-109 110, and 207 (Dec. 8, 1982), 1 Kan. Reg. 1355-56 (oil and gas wells).

40. Kan. Stat. Ann. Sec. 55-604 (C) (c) (1976) (oil); Kan. Stat. Ann. Sec. 55-703 (Supp. 1982) (gas).

41. See Ohio Oil Company v. Indiana, 177 U.S. 190 (1900); Section of Mineral Law of the A.B.A. Legal History of Conservation of Oil and Gas 7-8 (1939) (hereinafter cited as Legal History).

42. See Walls v. Midland Carbon Co., 254 U.S. 300 (1920).

43. See generally Hardwicke, Oil Conservation Statutes, Administration, And Court Review, 13 Miss L.J. 381, 393-95 (1941) (hereinafter cited as Oil Conservation Statutes).

44. Elliff v. Texon Drilling Co., 146 Tex. 575, 210 S.W. 2d 558 (1948); Louisville Gas Co. v. Kentucky Heating Co., 117 Ky. 71, 77 S.W. 368 (1903); Manufacturers' Gas & Oil Co. v. Indiana Gas & Oil Co., 155 Ind. 461, 57 N.E. 912 (1900).

45. See e.g., Tex. Const. art. 16, Sec. 59(a) (1917). Kan. Stat. Ann. Sec. 55-601 (1976) (oil) and Kan. Stat. Ann. Sec. 55-701 (1976) (gas) prohibit the production of oil or gas "in such manner and under such conditions" as to constitute "waste."

46. Kan. Stat. Ann. Sec. 55-602 (1976) (oil); Kan. Stat.Ann. Sec. 55-702 (1976) (gas).

47. The Kansas Supreme Court, in Colorado Interstate Gas Co. v. State Corp. Com'n, 192 Kan. 2, 386 P.2d 266, 280-281 (1963), stated "(m)arket demand is that amount of a commodity which the consuming public is able and willing to buy." The Court further defined demand, quoting Webster, to include "the amount people are ready and able to buy at a certain price." 386 P.2d at 281.

48. "Allowable' means the amount of oil or gas authorized to be produced by order of the commission." Temporary Admin. Reg. Sec. 82-3-101 (2) (Dec. 8, 1982), 1 Kan. Reg. 1351.

49. "'Producitivity of a well' means the daily capacity of a well to produce oil or gas." Temporary Admin. Reg. Sec. 82-3-101 (44) (Dec. 8, 1982), 1 Kan. Reg. 1352. See also Kan. Stat. Ann. Sec. 55-603 and Sec. 55-604 (1976) (oil); Kan. Stat. Ann. Sec. 55-703 (Supp. 1982) and Sec. 55-704 (1976) (gas); Temproary Admin. Reg. Sec. 82-3-202 (Dec. 8, 1982), 1 Kan. Reg. 1361.

50. "'Attributable acreage' means the acreage assigned to a well in accordance with the well spacing program adopted for each of the prorated fields." Temporary Admin. Reg. Sec. 82-3-101 (5) (Dec. 8, 1982), 1 Kan. Reg. 1351.

51. Kan. Stat. Ann. Sec. 55-604 (C) (c) (1976). For a general discussion of how the Kansas proration system works, see Aylward Production Corp. v. State Corporation Com'n, 162 Kan. 428, 176 P.2d 861, 865-66 (1947).

52. Kan. Stat. Ann. Sec. 55-604 (C) (c) (1976) provides for the establishment of "spacing units" in an oil reservoir by the Corporation Commission. The Commission has responded by promulgating Temporary Admin. Reg. Sec. 82-3-307 (Dec. 8, 1982), 1 Kan. Reg. 1363. Kan. Stat. Ann. Sec. 55-703a (1976) gives the Commission authority to provide for spacing of gas wells.

53. Although some authorities believe the Kansas pooling situation has been solved with the enactment of the Kansas Unitization Statute, Kan. Stat. Ann. Sec. 55-1301 et seq. (1976), these statutes were created to permit field wide unitization and do not

address the consolidation of interests within a spacing unit. See Mobil Oil Corp. v. State Corp. Commission, 227 Kan. 594, 608 P.2d 1325, 1337 (1980) where Chief Justice Schroeder in his dissenting opinion indicates Kan. Stat. Ann. Sec. 55-1301 et seq. (1976) somehow offers the operator some relief when interests within a spacing or proration unit refuse to voluntarily pool their interests so their acreage will be attributable to the well for determining its allowable.

54. See generally Smith, The Kansas Unitization Statute: Part I, 16 Kan. L. Rev. 567 (1968); Smith, The Kansas Unitization Statute: Part II, 17 Kan. L. Rev. 133 (1968).

55. K. & L. Oil Co. v. Oklahoma City, 14 F. Supp. 492 (W. D. Okla. 1936). See also, Winkler v. Anderson, 104 Kan. 1, 177 P. 521 (1919) (State statute upheld prohibiting oil or gas wells within 100 feet of a railway right of way). But compare Clouser v. City of Norman, 393 P. 2d 827 (Okla. 1964) (Zoning ordinance prohibiting drilling of oil and gas wells is arbitrary and void when it has no reasonable relation to public health, safety, morals, or general welfare); Silva v. Township of Ada, 330 N.W. 2d 663 (Mich. 1982) (Zoning regulations which prevent the extraction of natural resources are invalid unless "very serious consequences" will result from the proposed extraction).

56. Spacing laws and regulations, and related production limitations, offer some protection to undeveloped lands, however, the basic Kansas conservation system is set up to protect against "uncompensated" drainage from developed lands. The only viable method for protecting undeveloped lands from drainage is to drill wells.

57. Kan. Stat. Ann. Sec. 55-211a (1976) provides in part:

58. The governing body of any municipal corporation. . . owning or having the managemnt and control of any tract of land within the State of Kansas, is hereby authorized and empowered to lease such lands. . . for drilling for oil or gas upon such terms as may be agreed upon: Provided, That any such lease shall contain provisions for spacing of producing wells in accordance with rules and regulations of the state corporation commission as provided by law.

(a) The governing body of any city or county which has established, acquired or otherwise assumed control of any cemetery or burial grounds shall prevent such cemetery or burial grounds from being used for dumping grounds, building sites, playgrounds, places of entertainment or amusement, public parks, athletic fields, parking grounds or any purpose other than for burial or other intended cemetery purposes.

(b) The fact that any tracts of land has been set apart for burial purposes and that a part or all of such tract has been used for burial purposes shall be evidence that such grounds were set aside and used for burial purposes regardless of whether graves are visible on any part of the grounds. For the purposes of this act, the terms "cemetery" and "burial grounds" shal mean parcels of land set aside and used for the interment of human bodies.

59. The cemetery example also points out a common problem with determining oil and gas rights in municipal property. The city attorney must carefully consider all applicable statutory and case law pertaining to a certain type of property, such as cemetery, parks, streets, etc. The city attorney will also have to do some preliminary

title examination on offered property to determine the type of grant the city received and any special restrictions or limitations placed upon its use of the property. These steps are absolutely essential to identify and avoid future problems.

60. See McRae, Granting Clauses in Oil and Gas Leases: Including Mother Hubbard Clauses, 2 S.W. Leg. Fdn. Oil & Gas Inst. 43 (1951)..

61. See supra notes 57-59 and accompany text.

62. For a good lessor-oriented article on the negotiation and effect of various lease terms, see Anderson, David V. Goliath: Negotiating the "Lessor's 88" and Representing Lessors and Surface Owners inOil and Gas Lease Plays, 27th Ann. Rocky Mtn. Min. L. Inst. 1029 (1982)

63. For additional background information on farmout and joint operating agreements, see the following articles: Klein and Burke, The Farmout Agreement: Its Form And Substance, 24th Ann. Rocky Mtn. Min. L. Inst. 479 (1978); Wigley, AAPL Form 610-1977 Model Form Operating Agreement, 24th Ann. Rocky Mtn. L. Inst. 693 (1978); Lamb, Farmout Agreements-Problems of Negotiation And Drafting, 8th Ann. Rocky Mtn. L. Inst. 139 (1963); Young, Oil and Gas Operating Agreements: Producers 88 Operating Agreements, Selected Problems and Suggested Solutions, 20th Ann. Rocky Mtn. L. Inst. 197 (1975).

64. Braly v. Board of Fire Commissioners, 157 Cal. App. 2d 608, 321 P.2d 504 (1958); Sindell v. Smutz, 100 Cal. App. 2d 10, 222 P. 2d 903 (1950). But see, Friel v. County of Los Angeles, 172 Cal. App. 2d 142, 342 P. 2d 374 (1959) and Adkins v. City of West Frankfort, 51 F. Supp. 532 (E. D. Ill. 1943).

65. In Bohrer v. Ramsey Petroleum, 141 Kan. 781, 44 P. 2d 239 (1935), the Kansas Supreme Court upheld a Chase, Kansas city ordinance which limited the number of wells to one per city block and required payment of proportionate royalties to all lot owners in the block. The ordinance was held to supersede any existing lease or contract to the extent necessary to give the ordinance effect.

66. This is normally done through liability insurance and surety bond requirements imposed on the permittee.

67. Gant v. Oklahoma City, 289 U.S. 98, 53 Sup. Ct. 530, 77 L. Ed. 1058 (1931) (Court noted "peculiar dangers" involved in drilling and operating oil or gas wells and upheld city ordinance requiring a surety bond from a bonding or indemnity company and which refused to accept personal sureties).

68. K. & L. Oil Co. v. Oklahoma City, 14 F. Supp. 492 (W.D. Okla. 1936). See also, Winkler v. Anderson, 104 Kan. 1, 177 P. 521 (1919) (State statute upheld prohibiting oil or gas wells within 100 feet of a railway right of way). But Compare Clouser v. City of Norman, 393 P. 2d 827 (Okla. 1964) (Zoning ordinance prohibiting drilling of oil and gas wells is arbitrary and void when it has no reasonable relation to public health, safety, morals, or general welfare).

69. Gruger v. Phillips Petroleum Co., 192 Okla. 259, 135 p. 2d 485 (1943); Keaton v. Oklahoma City, 187 Okla. 593, 102 P. 2d 938 (1940), cert. denied, 311 U.S. 616, 61 Sup. Ct. 75, 85 L. Ed. 391 (1940).

70. Ptak v. City of Oklahoma City, 204 Okla. 336, 229 P. 2d 567 (1951).

71. 1981 Code of Cherryvale, Kansas Sec. 6-410; the City of Cherryvale chose to permit oil and gas operations in any city zone so long as the activity met the regorous hearing, spacing, and performance requirements.

72. See, City of Hartshorne v. Marathon Oil Co., 593 P. 2d 97 (Okla. 1979) where the Supreme Court of Oklahoma stated:

> There is no doubt a city, under its police power, may enact ordinances regulating the drilling of oil and gas wells within its city limits. But to be valid, any ordinance must bear a reasonable relation to public health, safety, morals or general welfare.

City of Hartshorne, v. Marathon Oil Co., 593 P. 2d at 99.

See also, Clouser v. City of Norman, 393 P. 2d 827 (Okla. 1964).

73. Ordinances enacted under the police power are presumed valid. The party attacking the ordinance must clearly demonstrate it is an arbitrary or irrational exercise of the police power having no relation to the public health, morals, safety, or general welfare. Courts will not evaluate the wisdom of local legislative action. Blacett v. Montgomery, 398 S.W. 2d 877 (Ky. 1966); Adkins v. West Frankfort, 51 F. Supp. 532 (D.C. Ill. 1943); Marrs v. City of Oxford, 32 F. 2d 134 (8th Cir. 1929) cert. denied 280 U.S. 573, 50 Sup. Ct. 29, 74 L. Ed. 625 (1929).

74. State action may be in the form of comprehensive legislation to preempt local authority in the area. See, e.g., Union Nat. Bank & Trust v. Bd. of Supervisors of Kendall County, 65 Ill. App. 3d 26, 382 N.E. 2d (1978) (Strip mining regulation). Federal action may result from state and local permitting delays of major energy resources development projects. Consider, Fischer, Allocating Decisionmaking in the Field of Energy Resource Development: Some Questions and Suggestions, 22 Ariz. L. Rev. 785 (1981), where he discusses the Priority Energy Project Act of 1980 (PEPA) and the Energy Mobilization Board.

75. Adkins v. West Frankfort, 51 F. Supp. 532 (D.C. Ill. 1943) (City can adopt necessary ordinances to protect public from fire hazards associated with oil and gas wells).

76. Marrs v. City of Oxford, 32 F. 2d 134 (8th Cir. 1929) cert. denied 280 U.S. 573, 50 Sup. Ct. 29, 74 L. Ed. 625 (1929) (Ordinance upheld establishing minimum royalty and allocation of the royalty among surface owners).

77. In Oklahoma, by statute, a municipality is prohibited from imposing any production tax on the oil and gas operation. See, City of Hartshorne v. Marathon Oil Co., 593 P. 2d 97 (Okla. 1979).

78. Kan. Const. art. 12, Sec.5(d) makes it clear the court must interpret the powers and authority granted Kansas cities liberally "for the purpose of giving to cities the largest measure of self-government".

79. Friel v. County of Los Angeles, 172 Cal. App. 2d 142, 342 P. 2d 374 (1959). See generally, Annot., 10 A.L.R. 3d 1226 (1966).

80. Alkins v. City of West Frankfort, 51 F. Supp. 532 (D.C. Ill. 1943).

81. C. C. Julian Oil & Royalties Co. v. City of Oklahoma City, 167 Okla. 384, 29 P. 2d 952 (1934).

82. Bohrer v. Ramsey Petroleum Co., 141 Kan. 781, 44 P. 2d 239 (1935).

83. Ptak v. City of Oklahoma City, 204 Okla. 336, 229 P. 2d 567 (1951).

84. Gant v. Oklahoma City, 289 U.S. 98, 53 Sup. Ct. 530, 77 L. Ed. 1058 (1931).

85. City of Hartshorne v. Marathon Oil Co., 593 P. 2d 97, 100 (Okla. 1979).

86. Traffic considerations must be reasonably related to public safety, health and welfare. Pure Oil Div. of Union Oil Co. v. City of Brook Park, 26 Ohio App. 2d 153, 269 N.E. 2d 853 (1971) (Traffic patterns may be considered in zoning decisions but it is improper to use zoninglaws primarily to regulate traffic). But see, Gawl v. Atlantic Richfield Company, 27 Md. App. 410, 341 A. 2d 832 (1975) (Traffic impact is a sufficient basis to deny a zoning or special exception application).

87. In Marrs v. City of Oxfor,d 32 F. 2d 134 (8th Cir. 1929), cert. denied 280 U.S. 573, 50 Sup. Ct. 29, 74 L. Ed. 625 (1929), the Court noted:

> There will be annoyance from unsightly structures, disquieting noises of machinery, the immediate and constant presence of numbers of workmen and the persistent thought of impending danger from explosion . . . . Such a situation calls fro some governmental restriction and control.

Marrs v. City of Oxford, 32 F. 2d 134 at 140.

88. Union Pacific R. Co. V. City of Los Angeles, 43 Cal. App. 2d 824, 128 P. 2d 408 (1942), considers the problems slant drilling can cause for local regulators.

89. Clouser v. City of Norman, 393 P. 2d 827 (Okla. 1964). See generally, Gill, Intergovernmental Restraints on Oil and Gas Developments, 16 Land and Water L. Rev. 457, 466-67 (1981).

90. Silva v. Township of Ada, 330 N.W. 2d 663 (Mich. 1982); Certain-Teed Products Corp. v. Paris Twp., 351 Mich. 434, 88 N.W. 2d 705 (9158); North Muskegon v. Miller, 249 Mich. 52, 227 N.W. 743 (1929).

91. See Rush v. King Oil Company, 220 Kan. 616, 556 P. 2d 431 (1976) and Renner V. Monsanto Chemical Company, 187 Kan. 158, 354 P. 2d 326 (1960).

92. In Cherryvale, Kansas, the governing body specifically addressed zoning in its oil and gas ordinance as follows:

> 6-140. ZONING; PUBLIC NUISANCE. Drilling for oil or gas shall be permissible activity in all zones of the city when the requirements of this article and of a board approved permit can be met. The permittee shall not operate any oil or gas well, or any activity associated with the well, so as to constitute a public nuisance.

1981 Code of Cherryvale, Kan. Sec. 6-410.

See also note 93 infra.

93. If the governing body desires to permit oil and gas activities in all zones within a city, subject to the special requirements of a general ordinance regulating oil and gas operations, the city should treat such a provision as a general amendment to the city's zoning law. For such a provision to be valid, the notice, hearing, and recommendation requirements of Kan. Stat. Ann. Sec. 12-708 (1982) should be followed to effect a general revision to the city's zoning ordinance.

94. See, e.g. Cooper v. City of Great Bend, 200 Kan. 590, 438 P. 2d 102 (1968) Court enjoined use of park property for construction of parking lot).

95. See, e.g. Kan. Stat. Ann. Sec. 12-406 (1982) which provides:

> 12-406. Maps and Plats sufficient to vest title in lands conveyed for public use; effect of recordation. Such maps and plats of such cities and towns, and additions, made, acknowledged, certified, filed and recorded with the register, shall be a sufficient conveyance to vest the fee of such parcels of land as are therein expressed, named or intended for public uses in the county in which such city or town or addition is situated, in trust and for the uses therein named, expressed or intended, and for no other use or purpose, and the recording of such map or plat shall not constitute a conveyance of any interest in the oil, gas and other minerals underlying the avenues, streets, lanes, alleys, and other parcels therein named or intended for public uses. The provisions of this act shall apply to all maps or plats, heretofore or hereafter made, acknowledged, certified, filed and recorded wtih any such register: Provided, however, That nothing herein contained shall be construed as granting any right to enter upon the surface of such parcels of land for purposes of exploring for or the extraction of such minerals, or in any other manner to interfere with the public uses named in such maps, plats and additions.

See also City of Kechi v. Decker, 230 Kan. 315, 634 P. 2d 1099 (1981) (Discussing commonlaw and statutory dedications); Miller-Carey Drilling Co. v. Shaffer, 144 Kan. 508, 61 P. 2d 1320 (1936) (Dedication to city, by general warranty deed, of land necessary to extend a street, did not convey oil and gas rights in the land to the city. The city acquired title for street purposes only); Sutton v. Frazier, 183 Kan. 33, 325 P. 2d 338 (1958) (Condemnation of land did not vest improvement district with title to minerals underlying the condemned land), but see Board of Educ. of Unified Sch. v. Vic Regnier, 231 Kan. 731, 648 P. 2d 1143 (1982).

A detailed study of the title and use of dedicated and condemned municipal property would provide more than ample material to carefully consider the source of title for all municipal property, the nature of the grant, and all relevant case law. In most cases an independent title study will be required for each tract of municipal property you plan to offer for oil and gas development.