Approved March 22, 1983
Date

MINUTES OF THE Senate COMMITTEE ON Energy and Natural Resources.

The meeting was called to order by Senator Paul Feleciano, Jr. at
Chairperson

8:00 a.m. on Friday, March 18, 1983 in room 123-S of the Capitol.

All members were present except:
Senator Fred Kerr (Excused)
Senator Tom Rehorn (Excused)

Committee staff present:
Don Hayward, Revisor's Office
LaVonne Mumert, Secretary to the Committee

Conferees appearing before the committee:
Richard Brewster, Amoco
George Sims, Mobil
Don Schnacke, Kansas Independent Oil and Gas Association
Don Willoughby, Northern Natural Gas
Robert Anderson, Mid-Continent Oil and Gas

The minutes of the March 17, 1983 meeting were approved.

H.B. 2208 - Oil and gas leases; covenants of reasonable exploration

Richard Brewster summarized his written testimony (Attachment 1). They oppose H.B. 2208 because they feel it is unconstitutional. Mr. Brewster referred to two Attorney General opinions attached to his statement on bills similar to H.B. 2208. He said producers have always relied on the state of the law which means that production from one zone protects the right to explore the other zones. If this bill is passed, it would change that and no amount of activity on the part of the producer could protect those leases. He said the producers would be punished today for what they did yesterday, even though they were in compliance with the law yesterday. Mr. Brewster mentioned his company's seismic activities in the Hugoton Field. He explained the suggested amendments attached to his written statement. Mr. Brewster said his point is that the law is being changed and the producers are being told what they're doing is wrong. Senator Feleciano asked Mr. Brewster what he would anticipate would be a reasonable period of time, and Mr. Brewster said he didn't know.

Chairman Angell asked Mr. Doug Bendell how many acres are in one of his typical leases. Mr. Bendell said 160 acres is the maximum per instrument with a voluntary unitization clause for gas of 640 acres.

George Sims read his written statement in opposition to H.B. 2208 (Attachment 2). He said Mobil has drilled and is continuing to drill in this area. Mr. Sims stated that economics must be considered and it is reasonable to expect both parties to profit from a venture. They feel these matters are best settled in court. Mr. Sims showed the Committee a large map of a 60 by 75 mile area including the Hugoton Field. The map shows oil wells, gas wells and dry holes, all below 3,400 feet. Mr. Sims said most wells shown are 5,400 feet or below. Senator Feleciano asked why, after 15 years, the companies are not willing to give up leases where there are only dry holes. Mr. Sims said, in the industry, dry holes are used as benchmarks for further exploration.

Don Schnacke read his written testimony (Attachment 3). He raised the question of the constitutionality of the bill. He said Kansas law enforces the implied covenants to develop after oil and gas is found but does not enforce the implied covenant to explore. Mr. Schnacke suggested several amendments to the bill. He suggested that the Legislature should wait to see the outcome of Amoco v. Douglas Energy before acting on H.B. 2208. He said the bill puts in jeopardy leases that are used for obtaining loans. The bill has statewide application and would inhibit future secondary and tertiary recovery projects. Chairman Angell asked a question about dry holes. Mr. Schnacke said the determination of whether holes are dry is related to the potential commercial production that is available and must measure out and meet the economic test.

Don Willoughly said they believe the true reason for this bill is increased income to royalty owners. He said an increase in drilling activity could have this effect. Because these new wells would be at the 102 or 103 prices, which are $3.34 and $2.74, respectively, as of this

month. Mr. Willoughby said they do the reservoir studies for the Hugoton Field for the American Gas Association which is made up of pipeline companies and gas distribution companies. He said there may be some small pockets, but there is no major field underlying the Hugoton. He raised the question of who will buy the gas from these new wells. He said only 6.3% of the Hugoton Field is dedicated to intrastate commerce. Mr. Willoughby said each well that comes on line raised the cost to the consumer.

Robert Anderson referred to a letter from O. B. Seay of Cities Service Company (Attachment 4). In the last eight years, they have spent 60 million dollars drilling an average of two wells a month in the Hugoton Field that are below the original zone. They think H.B. 2208 is intended to reform leases. Mr. Anderson mentioned the pending litigation in Amoco v. Douglas Energy and urged that no action be taken on H.B. 2208 until this case is determined. He stated that each new well gets a "piece of the action", so when the higher cost for new wells is added in, the average cost to the consumer goes up. Mr. Anderson also mentioned enhanced recovery projects.

The meeting was adjourned at 9:01 a.m. by the Chairman. The next meeting of the Committee will be at 8:00 a.m. on March 22, 1983.

Senate Energy & Natural Resources

Mar. 18, 1983

Name	Organization
Douglas Bendell	Douglas Energy
Dick Brewster	[illegible]
Spencer Bendell	Bendell Investments
George Adams	Mobil
Don Willoughby	INI
Lon Stanton	KPL
Robert A. Anderson	Mid-Cont Oil & Gas
Jack Glaves	Anadarko Production
David W Nickel	KCC
Leroy Hayden	Legislator
Glenn Cogswell	Northwest Central Pipeline

Attachment 1

Amoco Public & Government Affairs
P. O. Box 2920
Shawnee Mission, Kansas 66201
913/661-2101
Representing
Amoco Chemicals Corporation
Amoco Oil Company
Amoco Pipeline Company
Amoco Production Company

E. Richard Brewster
Government Affairs Representative

March 17, 1983

Senate Committee on Energy and Natural Resources
State Capitol Building
Topeka, Kansas 66612

House Bill No. 2208

Mr. Chairman, members of the Committee, my name is Dick Brewster, and I am Governmental Affairs Representative for Standard Oil Co. (Indiana), and appear today on behalf of Amoco Production Company, a wholly-owned subsidiary of Standard. Amoco has substantial production operations in southwest Kansas, primarily in the Hugoton field. We produce natural gas which is dedicated by contract and law to the interstate market, and which is sold to to the successor of Cities Service Gas Company, Northwest Central Pipeline.

We oppose House Bill 2208 for a number of reasons. In November of 1976, during an interim study of the concept advanced in this bill, Chairman J. C. Tillotson received an opinion from the Attorney General on House Bill 3038. The opinion concluded that the measure was fraught with constitutional problems. In January, 1977, the then Chairman of the House Committee on Judiciary, in response to his request, received an opinion from the Attorney General on House Bill No. 2002. The conclusion was that the bill had serious constitutional problems. Both these bills are identical in intent and similar in language to House Bill 2208.

I have read the memorandum prepared by the Washburn University Law professor on the bill and note his conclusion that "...it is improbable that the legislation would suffer a constitutional disability." I would commend to you the reading of both Attorney General Opinions and the memorandum. Regardless of which opinion is ultimately adopted by the courts, this measure is clearly one which we would all expect to see litigated. As Mr. Bendell told you Tuesday, the mere probability that legislation will be litigated is of itself no reason to defeat a bill. However, I do believe we should look at the consequences of protracted litigation as those consequences will affect the purpose of the legislation itself. I would suggest the rights of all parties would be open to question during such litigation and that producers would be reluctant to invest in exploration activities until the rights were determined by the courts.

Atch. 1

You should be aware, by way of background, of recent activities on this subject. Douglas Energy Company began a leasing program in the Hugoton area last year. Through a series of meetings with royalty owners, Douglas entered into lease agreements with a large number of mineral owners, giving Douglas the right to drill to formations below the existing producing zones. Many of these leases were on land already leased by Amoco Production Company and on which Amoco has producing wells from the Hugoton embayment. Douglas made these leases a matter of record by filing them with the Register of Deeds in the appropriate counties. Amoco, believing these leases to be a cloud upon our leases and improper, commenced litigation against Douglas and the mineral owners in Federal District Court in Wichita. That litigation is now pending.

While Amoco does not desire to try these issues before this committee, it should be pointed out that Douglas apparently believes this bill is not necessary. Douglas must have concluded that Amoco's rights to these deep horizons has automatically terminated, and that the landowner need not commence a lawsuit as contemplated by this bill. It seems to me that if the court rules against Amoco this bill would be completely unnecessary. If Douglas wins, and the existing leases of Douglas are determined to be valid, then the mineral owners who signed those leases did not need this bill. But what of the other landowners? Are they required to go to court if this bill is passed, whereas those who signed with Douglas initially did not have to do so? I am merely suggesting that this committee should withhold any decision on this bill until the lawsuit is concluded. The suit deals directly with the issues presented by the bill, and once the court has spoken, you will be in a better position to make decisions on these issues.

There are several other reasons we oppose H.B. 2208. In its present draft, it cuts off the right of an existing shallow producer to correct any alleged failure to properly explore. Assuming the bill is constitutional, it amounts to a legislative statement to Amoco and other producers that we can no longer rely on existing shallow production to protect our future right to explore and develop deeper horizons. I do not believe anyone would disagree with the statement that Amoco, other producers, and mineral owners have heretofore believed we could retain our rights to the deeper horizons with shallow production. I would therefore urge you to amend the bill so that we have a reasonable time in which to conform our actions to the new rules, if you determine those rules should now be changed.

Section 3 of the bill requires us to overcome the presumption by showing that we did comply with the covenant before we were on notice that we had to, or that the covenant existed. I would urge you to consider an amendment requiring the court to grant an existing shallow producer a reasonable time in which to comply with the covenant created by the bill, if it is determined by the court that we have failed to comply.

This seems only fair. If the bill passes, we are being told that we should have taken certain action before we were told that such action is required of us. We should have the opportunity to take that action before our rights are forfeit.

You have also been told that this bill will mean more less expensive gas for Kansas. This is simply not so. Existing gas production in the Hugoton area is subject to price controls by federal law. As you well know, there is not sufficient market for this gas now, let alone any additional gas. New wells, drilled to deeper pay zones, if gas is found, will be subject to considerably higher prices. Thus, to the extent that any new gas is actually found and produced as the result of this legislation, and to the extent that any such gas is marketed, it will increase the price to consumers of Hugoton gas, many of whom are Kansas residents and business operations.

You have been told that the major operators in the Hugoton field have virtually ignored deep horizons potential over the years. I have been advised that some ~~nine hundred~~ deep wells have been drilled in Southwest Kansas. Since 1940, Amoco has drilled nearly three hundred such wells, 61 of them since 1973. Of these, over 40 have been drilled within the confines of the Hugoton field itself. Presently, Amoco has two seismic crews operating in Southwest Kansas and plans call for wildcat deep drilling when the seismic activity is complete. Amoco has always been and remains committed to the development of domestic oil and gas reserves. There is certainly no reason to believe that Amoco will fail to explore and drill to the deeper pay zones in Kansas when market conditions and geological conclusions justify such drilling.

I would respectfully suggest another amendment to the bill, if you believe the bill should be passed. Any covenant to explore and develop should take into consideration all relevant data, including market demand, economic viability of exploration and development and the need for additional reserves. I would urge you to give the courts some direction in determining whether a producer has breached his duty, by listing these and perhaps some other relevant factors, not by way of limitation, but by way of inclusion.

This bill also jeopardizes the right of any producer who discovers a new pool of oil or gas in the deep horizons to fully develop that discovery. For example, if a discovery is made in deep horizons on one lease, the discoverer would want to preserve his right to develop that discovery by drilling offset or development wells on adjoining leases. He would have to be able to count on his right to do so in order to justify the risk and cost of the discovery well. Yet, with this bill in place, an adjoining lessor, once the discovery is made, could bring the court action, terminate the producer's right to deep horizons on that adjoining lease, and seek another producer to develop the discovery made by the first producer. I would suggest that this result would act to

discourage the initial discovery effort. The first producer, the discoverer, would not have the opportunity to develop what he discovered if he had not explored the adjoining lease prior to the time the adjoining mineral owner commenced his lawsuit under this bill.

In summary, it seems to me that this bill is just not sound policy. No other state has such a law. It would ultimately discourage the very production it is supposed to encourage. Existing producers in the Southwest Kansas area are in business to make a profit for themselves, their stockholders and their royalty owners. When economic and market conditions warrant, they will explore and develop these deep horizons. In the meantime, it seems to me they should be able to rely on the present state of the law to protect rights we all agree they have now.

Thank you for your attention. I will be glad to answer any questions.

E. Richard Brewster

March 17, 1983

Suggested amendments to H. B. 2208

Page 1, line 40, after the comma, inserting the following:

"and (c) the mineral owner has received a bona fide offer to explore by drilling such subsurface part or parts by a producer not a lessee at the time such action is commenced,"

Page 2, line 46, after the period, inserting the following:

"In determining whether the lessee has fully complied with such covenant, the court shall consider all relevant evidence, including but not limited to the economic feasibility of such compliance, the marketability of any oil, gas or other minerals sought to be developed, prior drilling or other exploratory activity on such lease and upon surrounding leases, and other geophysical and geological data."

Page 2, line 47, inserting New Section 4 as follows:

"If the court determines that the lessee has failed to comply with such covenant prior to the commencement of the action authorized by this act, the court shall grant said lessee a reasonable time to comply. If, upon the expiration of such reasonable time as the court may determine and upon a hearing, the court determines that the lessee has not complied with such covenant, the court shall issue its order terminating the lessee's right to such subsurface part or parts as are the subject of the action and authorizing the lessor to enter into a mineral lease agreement with any producer as to such subsurface part or parts which are the subject of such action. If the court determines that the lessee has complied with such covenant, the court shall dismiss the action and may assess costs as the court may determine." And, renumbering the existing sections accordingly.

Page 2, line 55, inserting New Section 6, as follows:

"The presumption created by this act shall not apply to land within five miles of a new discovery well." And renumbering the existing sections accordingly.

STATE OF KANSAS

Office of the Attorney General

1st Floor, State Capitol Bldg. (913) 296-2215 Topeka, Kansas 66612

Curt T. Schneider
Attorney General

January 24, 1977

ATTORNEY GENERAL OPINION NO. 77-29

The Honorable E. Richard Brewster
State Representative
Chairman, Judiciary Committee
3rd Floor - State Capitol Building
Topeka, Kansas 66612

Re: Oil and Gas--Leases--Conditions

Synopsis: The effect of section 1 of 1977 House Bill 2002 is to impose upon lessees a duty to develop every subsurface zone of a producing leasehold as a condition of the implied covenant of reasonable development, a condition which does not now exist, and to create a presumption of breach of that covenant as a ground for partial termination of the lease upon the showing prescribed in section 1 thereof, and thus operates to impair contractual rights and obligations of lessees under existing leases, in violation of Article I, § 10 of the United States Constitution.

* * *

Dear Representative Brewster:

Article I, § 10 of the United States Constitution provides, inter alia, that "No State shall . . . pass any Law impairing the Obligation of Contracts." [Emphasis supplied.] You inquire whether 1977 House Bill 2002 is such a law. In my judgment, it is a contrived and ill-disguised attempt to abridge the rights of parties to existing oil, gas and oil and gas leases, which is subject to precisely the same objections which were recited in Opinion No. 76-342 regarding 1976 House Bill 3038.

Section 1 of the bill provides that in an action for relief based upon an alleged breach by a lessee of an implied or express covenant

of reasonable exploration or development of lands covered by an oil, gas, or oil and gas lease which is held by production, a presumption of breach by the lessee arises upon a showing that 1) production on the lease commenced at least 15 years prior to commencement of the action, and 2) that at the time the action was commenced there was no wellhead production from any "subsurface part or parts" of the leasehold as to which relief is sought.

The bill seeks to avoid the prohibition of Article I, § 10 by the recital in section 4 that "[e]xcept as expressly required hereby, this act shall not alter or affect substantive rights or remedies under any such leases. . . ," and by denominating the presumption merely "evidentiary."

If it is presumed that a lessee has breached an express or implied covenant of reasonable development by failure to develop every subsurface zone or horizon of a leasehold on which production has been maintained for 15 years, then it is also presumed that production from every subsurface zone is a condition of the implied covenant, and that the lessee has an affirmative duty to commence production from every such subsurface zone or horizon. There can be no breach without a condition to be breached, or a duty to be met. If a presumption of breach arises, it may do so only because there exists a duty or condition to be breached.

Clearly, there is no such condition implied today in this state. In Opinion No. 76-342, we referred to Stamper v. Jones, 188 Kan. 626, 364 P.2d 972 (1961), in which the court outlined the scope of the implied covenant of prudent development:

> "There is an implied covenant . . . that the tract will be prudently developed, and where the existence of oil in paying quantities is made apparent, it is the duty of the lessee to continue the development of the property and to put down as many wells as may be reasonably necessary to secure the oil for the common advantage of both the lessor and the lessee.
>
> A lessee, under the implied covenant to develop an oil and gas lease, is required to use reasonable diligence in doing what would be expected of an operator of ordinary prudence, in the furtherance of the interests of both the lessor and lessee. Under this rule neither the lessor nor the lessee of an oil and gas lease is the sole judge of what constitutes prudent development of the tract.

> A lessor who alleges breach of the implied covenant to develop has the burden of showing, by substantial evidence, that the covenant has been breached. He must prove that the lessee has not acted with reasonable diligence under the facts and circumstances of the particular situation at the time." 188 Kan. at 631. [Citations omitted.]

The diligence with which the lessee must proceed is measured by a number of considerations. In Fischer v. Magnolia Petroleum Co., 156 Kan. 367, 133 P.2d 95, (1943), the court stated thus:

> "It has generally been recognized that in determining whether there is a prudent development under the lease there are various pertinent factors to be considered -- all the facts and circumstances which would affect the reasonableness of an ordinarily prudent operator's position in connection with development of the particular tract involved. . . . In Brewster v. Lanyon Zinc Co., . . . [140 Fed. 801], the circuit court of appeals said:
>
> 'Whether or not in any particular instance such diligence is expressed depends upon a variety of circumstances, such as the quantity of oil and gas capable of being produced from the premises, as indicated by prior exploration and development, the local market or demand therefor or the means of transporting them to market, the extent and results of the operations, if any, on adjacent lands, the character of the natural reservoir -- whether such as to permit the drainage of a large area by each well -- and the usages of the business.'" [Citations omitted.]

In no case has the Kansas Supreme Court yet held that a lessee has an affiramtive duty to commence production from every subsurface zone of a leasehold, and under existing statutory and case law, it clearly appears that a lessor could not obtain judicial relief terminating a lease as to one or more subsurface zones merely by showing production from other zones of the leasehold

for fifteen years and no wellhead production from those as to which relief is sought. The effect of the statutory presumption is to permit lessors to obtain such relief on precisely such a showing; i.e., that showing alone raises a presumption that a condition of the implied covenant to develop has been breached. If the condition has been breached, it is necessarily a condition of the covenant in the first instance, and clearly, it is a condition which attaches only as a result of section one of 1977 House Bill 2002, in order to give effect to the presumption raised by that section. If the legislature were forthrightly to enact legislation requiring a lessee to have commenced production from every single subsurface zone of a leasehold which had been held by production for fifteen years, and entitling the lessor to judicial termination as to those zones from which production had not been commenced, clearly such legislation would be void as an attempt to impair existing contractual obligations.

Section 1 of House Bill 2002 seeks to accomplish the same object but only covertly, through the use of a so-called "evidentiary presumption" which has no other operative effect but to permit a lessor to terminate a lease as to one or more subsurface zones on grounds which would not support that relief prior to enactment of the bill.

It may be argued, of course, that the presumption is rebuttable and that the lessee may dispel or overcome it by showing that development of the leasehold has in fact been reasonable, prudent and diligent despite lack of production of a particular subsurface zone. The United States Supreme Court has held "more than once that a statute creating a presumption which operates to deny a fair opportunity to rebut it violates the due process clause of the Fourteenth Amendment." Heiner v. Donnan, 285 U.S. 312 at 329, 76 L. Ed. 772, 52 S. Ct. 358 (1932). However, under the bill, the lessee is called upon to justify failure to commence production from every subsurface zone not in production at the time the action is commenced, notwithstanding prior to its enactment, the lessee had no legal duty under the implied covenant of reasonable development, as outlined by the Kansas Supreme Court, to develop every such zone, in the first instance.

In Opinion No. 76-342, we quoted from Oil-Fork Development Co. v. Huddleston, 202 Ky. 261, 259 S.W. 334 (1924) thus, which remains as pertinent to this bill as it was to the last:

> "The obligation of contracts is impaired by a statute which alters its terms by imposing new conditions, or dispensing with

> conditions, or which adds new duties or rights, or releases or lessens any part of the contract obligation, or substantially defeats its end. . . ."

In my opinion, the effect of section 1 of 1977 House Bill 2002 is to impose upon lessees a duty to develop every subsurface zone of a leasehold as a condition of the covenant, either express or implied, of reasonable development, a condition which did not exist prior to enactment of the bill, and to create a presumption of breach of that covenant upon the factual showing prescribed in section 1. Clearly, in my judgment, the bill operates to impair contractual rights and obligations of lessees under existing leases, which is prohibited by Article I, § 10 of the United States Constitution.

Yours very truly,

Curt T. Schneider

CURT T. SCHNEIDER
Attorney General

CTS:JRM:kj

STATE OF KANSAS

Office of the Attorney General

1st Floor, State Capitol Bldg. (913) 296-2215 Topeka, Kansas 66612

Curt T. Schneider
Attorney General

November 15, 1976

ATTORNEY GENERAL OPINION NO. 76-342

The Honorable J. C. Tillotson
State Senator
109 South State
Norton, Kansas 67654

Re: Oil and Gas--Leases--Conditions

Synopsis: House Bill No. 3038, if enacted, would authorize partial termination of natural gas leases for breach of a condition imposed on such leases by the bill itself, and thus, if enacted, could not constitutionally be applied to any lease executed prior to the effective date of such law.

* * *

Dear Senator Tillotson:

You inquire concerning House Bill No. 3038, introduced by Representative Farrar, which is being studied by the Special Committee on the Judiciary which you chair.

Section 1 of the bill purports to authorize termination of natural gas leases under certain circumstances. Specifically, it provides that "[w]henever a natural gas lease permits the production of natural gas from all subsurface zones" and surface access for that purpose, the holder of the fee interest in the surface may be entitled to a judicial decree terminating production rights under the lease "from any subsurface zone not presently or previously brought into production," as well as the "rights of entry or occupation as to all or some" of the surface, if the court finds, among other facts, that 1) the lease was executed more than 25 years prior to commencement of the action; 2) that the lessee is not or has not previously during that period "made any effort to commence production of natural gas from such subsurface zone or zones; and 3) that termination will not interfere with the lessee's existing production

rights in other subsurface zones which are not the subject of the termination action.

You advise that the question has been raised whether the bill, if enacted, would operate as an impairment of existing contractual lease obligations.

In Kansas, absent express provisions in the lease, there is an implied covenant by the lessee to undertake prudent development of the leased tract. The broad general outline of this duty was described in *Stamper v. Jones*, 188 Kan. 626, 364 P.2d 972 (1961) thus:

> "There is an implied covenant . . . that the tract will be prudently developed, and where the existence of oil in paying quantities is made apparent, it is the duty of the lessee to continue the development of the property and to put down as many wells as may be reasonably necessary to secure the oil for the common advantage of both the lessor and the lessee.
>
> A lessee, under the implied covenant to develop an oil and gas lease, is required to use reasonable diligence in doing what would be expected of an operator of ordinary prudence, in the furtherance of the interests of both the lessor and lessee. Under this rule neither the lessor nor the lessee of an oil and gas lease is the sole judge of what constitutes prudent development of the tract.
>
> A lessor who alleges breach of the implied covenant to develop has the burden of showing, by substantial evidence, that the covenant has been breached. He must prove that the lessee has not acted with reasonable diligence under the facts and circumstances of the particular situation at the time." [Citations omitted.] 188 Kan. at 631.

The diligence which the lessee must demonstrate is to be measured by a number of considerations. In *Fischer v. Magnolia Petroleum Co.*, 156 Kan. 367, 133 P.2d 95 (1943), the court stated thus:

> "It has generally been recognized that in determining whether there is prudent development under the lease there are various

> pertinent factors to be considered -- all the facts and circumstances which would affect the reasonableness of an ordinarily prudent operator's position in connection with development of the particular tract involved . . . . In *Brewster v. Lanyon Zinc Co.*, . . . [140 Fed. 801], the circuit court of appeals said:
>
> "'Whether or not in any particular instance such diligence is exercised depends upon a variety of circumstances, such as the quantity of oil and gas capable of being produced from the premises, as indicated by prior exploration and development, the local market or demand therefor or the means of transporting them to market, the extent and results of the operations, if any, on adjacent lands, the character of the natural reservoir -- whether such as to permit the drainage of a large area by each well -- and the usages of the business.'" [Citations omitted.]

The costs of drilling, equipment and operation of wells, costs of transportation and storage, prevailing prices, and general market conditions as influenced by supply and demand or by governmental resolution or both must be considered.

There are many Kansas cases concerning the lessee's implied covenant to develop, and it would unduly lengthen this opinion to attempt to canvass even a few selected cases here. *See*, 3 Summers, *Oil and Gas* § 464 (2nd ed.) The extent of the lessee's duty is determined essentially by a standard of reasonableness. In *Berry v. Wondra*, 173 Kan. 273, 246 P.2d 282 (1952), the court quoted from *Merrill on Covenants Implied in Oil and Gas Leases*, § 57 (2nd ed.) thus:

> "Where oil or gas is discovered in paying quantities, and, as is usually the case, there are no express provisions governing the drilling of additional wells, it is held uniformly that there is an implied covenant to drill as many wells as are reasonably necessary to develop the premises and to secure the oil or gas for the mutual benefit of the lessor and the lessee."

Attachment 2

HB 2208

Mr. Chairman and Members of the Committee

I am opposed to House Bill 2208 for the following reasons:

1. These leases were freely entered into at the time of execution.
2. A large number of these leases contained 640 acre pooling clauses when executed.
3. In many cases even though leases contained 640 acre pooling clauses the companies asked and received voluntary units to form 640 acres.
4. The ~~pooling~~ Pooling from order of the commission was opposed by some of the companies as it forced them to share their market. (The purpose of the order was to protect correlative right by the limiting of the production so that each lease was potentially allowed to produce all the gas which was lying under it.)
5. Mobil has drilled and is continuing to drill in this area.
6. Mobil or its predecessors has farmed out acreage in many areas covered by its leases and will continue to do so.
7. The present rule in Kansas is commonly called the reasonable and prudent operator rule. In short this means the operator is required to operate in a manner which is consistent with practices of oil and gas industry.

Atch. 2

8. Economics also comes into play in this procedure and a number of cases have stated that in order to require an operator to drill a well it must be reasonable to expect both parties to profit from the venture.

9. We have always stated these matters are best settled in the courts and apparently Douglas Energy believes the present law is sufficient as they took their leases and agreed to bring the action to make them valid even though this law was not on the books.

10. I wish to show you a map of the area in which the proponents claim there is little or no exploration. In my opinion there is and continues to be exploration in this area and development is proceeding in a reasonable and prudent manner.

11. Under present law it appears to us this area will remain committed to the present markets it is now committed to even though an attempt will be made to have it abandoned from its present commitment. I make no attempt to predetermine what the law will be in the future as to federal laws.

We ask you not to change the rules and pass a law which is in conflict with present case law. There has been no shortage of these cases in the courts and if Douglas Energy proceeds with its action it appears there will be no shortage in the future.

Mobil Oil Corporation
George A. Sims

3/16/83

Attachment 3

KIOGA

KANSAS INDEPENDENT OIL & GAS ASSOCIATION

500 BROADWAY PLAZA • WICHITA, KANSAS 67202 • (316) 263-7297

Re: HB 2208 March 18, 1983

HB 2208 is similar to bills introduced since 1976. Two AttorneyGeneral opinions stated in 1976 and 1977 it was unconstitutional.

Kansas law now is that there is an implied covenant to presently produce a lease. Lawsuits on this issue are common. Prior testimony has indicated that many landowners have not pursued this remedy in the courts - but rather they would look to the legislature to legislate something that is available to agrieved parties.

We think the work "development" in the title and lines 27, 32, & 53 should be deleted. Kansas law enforces the implied covenant to develop the drilling of more wells after oil and gas is found. Kansas law does not enforce the implied covenant to explore - drill to new depths or on parts of a lease where there is no geological reason to drill.

This measure has been referred to a "deep rights" bill. We refer you to lines 35-38 which can be interpreted that this bill would apply to horizontal interests. We believe that should be clarified so that this bill would not apply to horizontal development and in conflict with the implied covenant to develop.

1983 is different than 1982. This issue is now before the Federal Court in Kansas in Amoco vs. Douglas Energy. We think that case is important and the legislature should wait to see what the out come of that suit will develop.

This bill puts in jeopardy leases that normally are used to show the lending industry a justification for loans.

This bill is state wide legislation and effects oil and gas leases throughout Kansas. There is strong opposition to this legislation in our industry.

The bill would inhibit future secondary and tertiary recovery projects - forcing the giving up of a lease in the middle of a project.

This bill would require forced exploration. The standard for the burden of proof would shift to the lessee, contrary to Kansas law. The burden of proof on the part of the lessee is next to impossible - the showing of production in all zones.

If you are serious about this bill and you recognize this problem exists only in the Hugoton field, consisting of 9 counties, then why not restrict it to those counties?

We recommend that it be restricted to "zones lying 50 feet above the Morrow formation and all zones below".

Atch. 3

SB 586 (1982) also had language that indicated the evidence had to include "(c) the lessee has not reasonably tested through drilling operations on such part or parts of such lease which is the subject of the action for relief". We think the entire burden of proof should not shift away from the lessor.

SB 586 (1982) restricted it to horizons below 3500 feet. We would support 4500 feet. We think 15 years is too short. It should be 20 - 25 years.

We do not believe there is a need for the legislation to act on this bill. We recommend it not be passed.

Donald P. Schnacke

Attachment 4

CITIES SERVICE COMPANY
ENERGY RESOURCES GROUP

Box 300
Tulsa, Oklahoma 74102

FOR HAND DELIVERY

March 17, 1983

The Honorable Charley L. Angell
Chairman
Senate Energy and Natural
Resources Committee
Kansas State House
Topeka, Kansas 66612

RE: Opposition to H.B. 2208

Dear Mr. Chairman and Members of the Committee:

My name is Blake Seay and I am General Manager of the Mid-Continent Region for Cities Service Oil and Gas Corporation. The Mid-Continent Region includes our Kansas operations and this fact, as well as being a former Kansas resident and petroleum engineer, prompts my comments on behalf of the Corporation on H.B. 2208. I appreciate this opportunity to offer our views and hope they will be useful in evaluating our opposition and your position on this "deep rights" bill.

H.B. 2208 expresses a legislative intent upon which we can all agree. Effective and timely development of leases is a desirable goal for the country, mineral owners, and producing companies. Cities Service Oil and Gas Corporation opposes H.B. 2208, however, because it is bad public policy.

We are aware of the strong feelings of royalty owners. They want their royalties from potential production as soon as possible and this is clearly a goal producing companies like Cities Service share as well. But as legislators, you must be concerned with the long view even if it means resisting current and popular views. Cities Service believes circumstances in the real world do not change as rapidly as sentiment does.

The basic relationship between companies and royalty owners is inherently one of mutual trust and partnership. Despite years of planning exploration and production plays and the expenditure

Att. 4

of large sums of money, not all leases are developed as timely--or as successfully--as all parties planned. The lessors take the financial risk and the royalty owners have to endure with us planned or unplanned delays which may lead to ultimate disappointment.

For instance, leases must be developed in a way which will not damage the reservoir and future producing capability. Additionally, production is now occurring through new technologies that were not possible a few years ago. Had some of these leases been "developed" pell-mell in an attempt to satisfy some arbitrary legislative mandate, future production--and thus royalty income--could have been lost. There are also many permitting, regulatory and surface owner delays which prolong "reasonable" exploration or development--however they are defined.

Furthermore, companies must evaluate a lease on the basis of its financial commitments and likelihood of success at the current time and under current operating conditions vis a vis other leases and the company's cash flow position. As practically everyone knows, oil companies have less money today than in the recent past. This is a situation that will change, but we do not feel it is wise to "box companies in" when they are affected by factors beyond their control.

Of course, the bill allows for these aforementioned contingencies as well as others by calling for reasonable measures. We believe it is extremely bad public policy for the legislature to be the forum of first resort in relatively individual disputes.

Cities Service has at all times complied with our leases for deep zones and protected our lessor from any drainage in producing reservoirs.

Our method of operation along with most other companies is well known. For instance in the last eight years Cities Service has drilled 288 wells in Kansas below the original horizon. That is, we have drilled--for the benefit of the country, royalty owners, tax coffers of all Kansas citizens, and, incidentally, ourselves--below the zone that was originally holding production at an average rate of one well every two weeks.

Let's talk dollars. In the past eight years this two well per month average has resulted in total direct costs of more than $60 million. In addition we have run seismic work and incurred numerous other costs on other undeveloped deep rights. We've spent this money and drilled these wells not so we can provide facts for your deliberations or to support our opposition to H.B. 2208, but because we literally leave "no stone unturned" in developing what we have. Given our continuing efforts and those of many others as well, we are concerned about what may be construed to be an "implied" convenent.

Where there are individual disputes as to "reasonableness," the courts are available for adjudication. In fact, a case is presently underway. We believe that it would be especially unwise to legislate when a private matter is before the courts. Lengthy, expensive and uncertain outcomes could be the result if the court and the legislature came to different conclusions. We do not mean to bait the legislature because we trust cooler heads will prevail and that legislation by intimation does not reign in the Kansas Senate.

The bill as written could create a literal grab-bag of legal concerns, precedents, and problems for everyone. And, in any case, such matters are like pressing down on quicksilver--squeeze in one place and the liquid merely squirts outward and forms a number of widely scattered droplets.

It is unclear to Cities Service if H.B. 2208 would apply to contracts retrospectively. We believe in the sanctity of private contracts freely entered into and the inappropriateness of government abrogation or amendment of such contracts.

These are some of our reasons we urge you to oppose H.B. 2208. Of course, there are others and we trust our views offer some perspective in evaluating the features of H.B. 2208 which will not serve the State of Kansas, its oil industry, or royalty owners well.

Thank you for your consideration of these views and for your continuing leadership.

Sincerely yours,

O. B. Seay
General Manager
Mid-Continent Region

OBS/jkp