

**The California Oil and Gas Report**

# Unitization Promotes Oil Field Development

### By Olman J. Valverde, Esq.

*Unitization under the California Public Resources Code provides an important legal tool for allowing oil and gas operators to access hydrocarbon resources.*

Imagine there is an attractive oil field that lies under several parcels of land.  An oil company has presented the landowners with a strong offer to develop the field as a unit.  The landowners talk and most think it is a good idea, but some are not interested and will not take the offer.  The project is threatened because the engineering design and financing requires control of all the land.

Is there a way to get around the impasse?  In California (and many other states) there is a procedure known as unitization that may provide a legal tool for accessing the minerals of the non-consenting landowners in exchange for fair and reasonable compensation.

Unitization provides a means for placing multiple parcels of land into a single unit and authorizing an oil company to extract hydrocarbons from all parcels within the unit, including compulsory participation by non-consenting landowners.

The procedures are set forth in certain provisions of the Public Resources Code (“**PRC**”) and California Code of Regulations (“**CCR**”), and are administered by the Division of Oil, Gas and Geothermal Resources (“**DOGGR**”).  This article provides a brief discussion of those procedures.

**I.  First Steps**

The PRC has detailed provisions for the management, development, and operation of acreage as a unit for the production of oil and gas. (Division 3, Chapter 3.5, Sections 3630 to 3690).

The first step in the unitization process is for the oil company to obtain approval of a proposed unit agreement from persons that hold at least three-fourths of the working interest and three-fourths of the royalty interest to the land that will be subject to the proposed unit. (PRC §3642).

After the threshold three-fourths approval is obtained, the unit operator begins the administrative process by filing a petition with the State Oil and Gas Supervisor (“**Supervisor**”) requesting approval of the proposed unit and unit agreement.  (PRC §3642).

**II.  Informational Requirements**

The PRC and CCR sets forth requirements for the type of information that must be included with the petition, such as (i) a report with appropriate engineering, reservoir, and geologic data and maps, (ii) certificate indicating that the requisite number of working interest and royalty interest owners have consented, and (iii) names and addresses of all persons listed in the county tax assessor’s records as to having an interest in the lands.  (PRC §3653.5; 14 CCR §1853).

The Supervisor may request additional data with regard to the petition, which must be submitted by the petitioner or unit operator to the Supervisor within 30 days of the request.  (14 CCR §1858).

PRC §3643 should also be consulted when preparing the petition.  This section sets forth certain findings that the Supervisor must make in order to approve the unit.  (PRC §3643).  The unit operator is therefore advised to review the nature of the required findings and, more importantly, to make sure that the petition is organized and includes the information necessary to support a decision by the Supervisor in favor of the required findings.

**III.  Notice of Hearing**

After the petition is filed, the Supervisor must provide notice to all persons shown by the records of the tax assessor to have an interest in the land proposed for unit operation, and shall give written notice to any city within which the land lies and, with respect to land which lies in an unincorporated area, to the county in which the land lies.  (PRC §3659).

Such city or county or any other interested person may, on any matter relevant to the proposed agreement for operation, submit testimony and evidence for the consideration of the Supervisor.  (PRC §3659).

**IV.  California Code of Regulations**

The CCR contains additional information regarding the hearing procedures, including the following:

* A public hearing regarding the petitions shall be held no later than 45 days after the date the petition was filed.  (14 CCR §1863(a)).
* If a request for additional data has been made by the Supervisor pursuant to 14 CCR §1858, the hearing shall be held no later than 75 days after the petition was filed.  (14 CCR §1863(a)).
* The Supervisor must provide written notice of the hearing no less than ten days prior to the date set for the public hearing.  (14 CCR §1864(c)).
* The notice sent by the Supervisor must be sent by regular mail to those persons and entities designated in PRC §3659 and to all persons whose names and addresses have been provided in the petition.  (14 CCR §1864(a)).
* The hearing on the petition must be presided over by the supervisor or by a deputy designated by the Supervisor.  (14 CCR §1865(a)).
* Within 60 days after the close of the hearing, the supervisor shall issue a written order granting or denying the petition in whole or in part.  (14 CCR §1865(c)).
* The written order shall state the facts upon which the Supervisor bases his or her decision and the reasons for the decision.  (14 CCR §1865(c)).

**V.  Protection for Non-Consenting Interest Owners**

**A.  Option to Force a Purchase**

The Supervisor’s order establishing the unit is effective and binding upon all persons owning an interest in the unit area from its effective date, regardless of whether they consented or did not consent to the unit.  In exchange for being placed into a unit, non-consenting owners have the right to force a purchase of their lands by the consenting owners.

The non-consenting owners in effect are given a “put”.  A significant aspect of the option right is that, if the option is exercised by the non-consenting interest owner, the Supervisor’s order approving the unit will not become effective until the purchase actually occurs.  The operative provisions are as follows:

* The non-consenting owners of any working interest or royalty interest in a tract or tracts of land which is subject of a unit agreement has 60 days following the date the Supervisor issues his order to offer his interest for sale. (PRC §3647).
* All working interest owners who consented to the proposed unit agreement have the option to purchase such interest in proportion to their respective shares of unit production. (PRC §3647).
* The order of the supervisor will not become effective unless one or more working interest owners purchase the non-consenting owner’s interests in the land. (PRC §3647).

**B.  Notice of Offer to Sell**

The non-consenting interest owners’ written notice of offer to sell their interest must be filed with the district deputy of the district in which the unit area is located. The notice must contain the following information pursuant to 14 CCR §1881(a):

* An identification of the approved unit agreement.
* A description of the tract offered for sale.
* An identification of the oil and gas interest offered for sale, whether royalty interest or working interest, with a reference to any specific lease or contract giving rise to that interest.
* The address where the offeror may receive any notices and communications regarding the offer.
* The price asked.

Within five working days after receipt of the notice, the Supervisor will send copies of the notice to the unit operator and all working interest owners who have consented to the unit agreement. (14 CCR §1881(b)).

**C.  Notice of Intention to Purchase**

Any working interest owner who wants to purchase the offered interest must file a notice of intention to purchase and give written notice to the offeror on or before the date provided by the Supervisor, which is no later than 30 days after the date of notice of offer of sale was filed.  (14 CCR §1881.5(a)).

Negotiations for the purchase of the offeror’s interest must be undertaken in good faith by both the offeror and the purchasers. Negotiations must be concluded on or before the date specified by the Supervisor, which is no later than 60 days after the notice of offer of sale is filed. (14 CCR §1881.5(b)).

If the purchase price is agreed prior to the specified date, the offeror must notify the supervisor immediately in writing, and the parties should expeditiously finalize the sale agreement. The sale agreement must be filed promptly with the Supervisor within 15 days after written notice of the agreed price is given to the Supervisor. (14 CCR §1881.5(c)).

**D.  Disagreement as to Price**

If a disagreement arises with respect to the price at which the interest is to be purchased, either party may request the Supervisor to authorize an arbitration committee to make an independent appraisal of the value of the interest as of the date the supervisor issued his order.  (PRC §3647; 14 CCR 1882(a)). The person electing arbitration shall file written notice with the Supervisor within five calendar days of the expiration of the negotiation period. (14 CCR 1882(b)).

The arbitration committee consists of three members, one member appointed by the seller, one member appointed by the purchaser(s), and a third member selected by the other two members. (PRC §3647). The committee is to consider all relevant data and information submitted by the parties, and may seek and consider other information as it deems relevant. (PRC §3647).

The arbitration committee shall determine the fair market value of the interests and fix the price at which the sale shall be consummated. (PRC §3647). The committee’s determination is final and binding on the parties. (PRC §3647).

However, within 30 days after the committee’s determination has been mailed to the concerned parties, the seller or purchaser may have such price judicially determined by filing suit for a declaratory judgment as to the fair market value in the superior court for the county in which the tract involved lies. (PRC §3647).

The compensation and expenses of the arbitration committee must be approved by the Supervisor. (PRC §3647). If the unit becomes effective, the expenses will be paid by the working interest owners who participated in purchasing such interest in the proportion they share unit expenses. (PRC §3647).

However, if the unit does not become effective within the time provided for in the Supervisor’s order, the consenting working interest owners who requested the independent appraisal will pay for the expenses proportionately. (PRC §3647).

**VI.   Appeal**

**A.  Appealing Supervisor’s Decision in Court**

The decisions and determinations made by the Supervisor are appealable within 60 days of the decision or determination in any court of competent jurisdiction by any person whose interests are affected. (PRC §3654).

**B.  Binding Upon All Interest**

The Supervisor’s order is effective and binding upon all person owning an interest in the unit area from its effective date. Each person has the right to enforce the provisions of the unit agreement whether or not that person expressly consented to the unit agreement. (PRC §3658).

**VII.  Conclusion**

The state of California allows for unitization in order to prevent waste and to increase the recovery of oil and gas.  The unitization process begins with the operator obtaining consent from the owners of at least three-fourths working interest in the area proposed to be unitized and three-fourths royalty interest in the area proposed to be unitized.  After the three-fourths consent is obtained, the operator files a petition with the Supervisor to approve the unit.

Non-consenting owners are bound by the unit agreement if the agreement is approved by the DOGGR supervisor.  However, non-consenting owners have a put option, which gives them the right to force a purchase of their land by the consenting owners.  If the non-consenting owners exercise their put option, the Supervisor’s order approving the unit will not become effective until the purchase actually occurs.

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