



# TEXAS

# VOLUNTARY POOLING

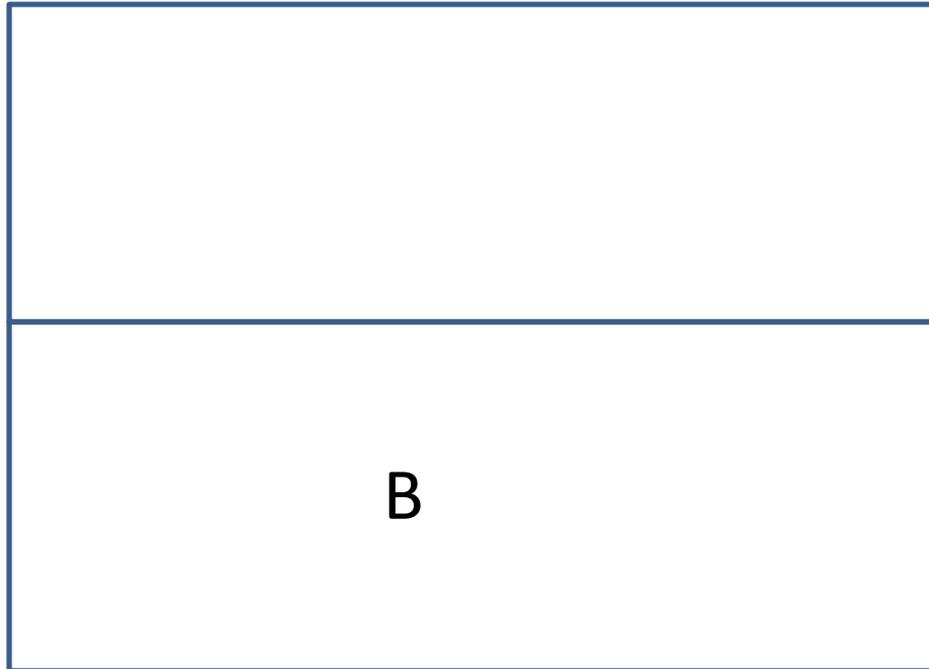
# THE COMMON LAW

A



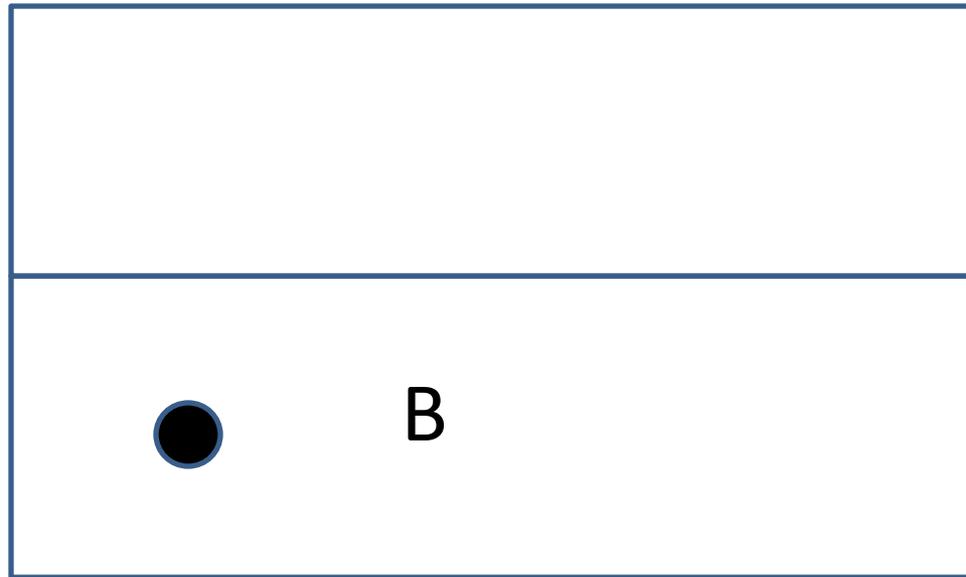
# THE COMMON LAW

A



# THE COMMON LAW

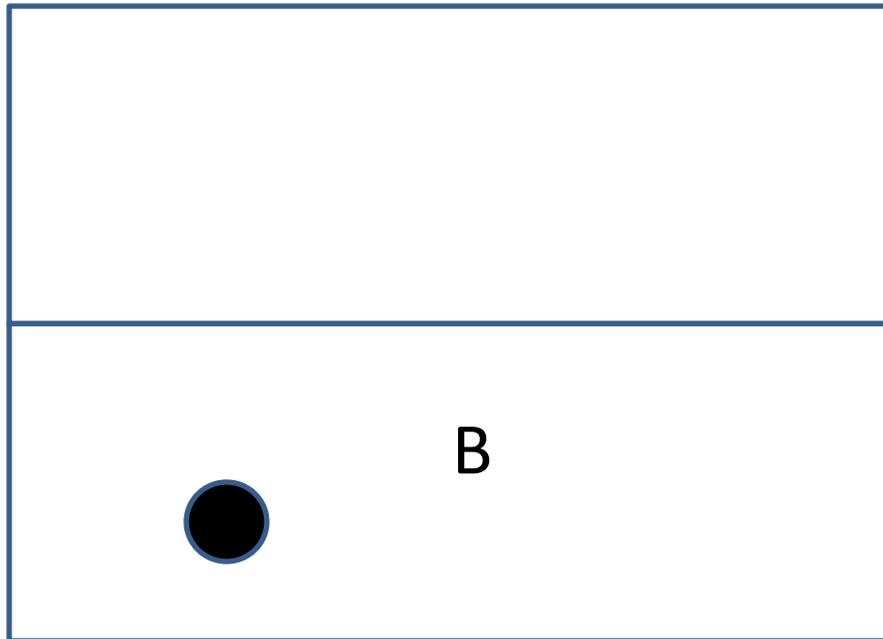
A



B

# THE COMMON LAW

A



Non-Appportionment

Entirety Clause



# THE COMMON LAW

## A. The Non-Appportionment Rule

*Japhet v. McRae* – Royalty is paid to the drillsite royalty owner only, unless there is:

1. pooling
2. a community lease
3. an entirety clause in the lease
4. a provision in the deed creating a separate tract that requires appportionment



# THE COMMON LAW

- B. Duty of Lessee to Lessor is Good Faith – not Fiduciary
- C. A Lessee signs the pooling agreement. Who are considered lessees?
  1. ORRO – no
  2. Farmoutor – maybe
  3. Agents and affiliates
  4. Lienholders – no



# THE COMMON LAW

## D. The Community Lease

1. Definition – One lease executed by the mineral owners of multiple tracts. The lessee is entitled to treat all tracts covered by the lease as a single “leased premises”. *Parker v. Parker*.
2. Negates the Non-Appportionment Rule by pooling all mineral owners as a matter of law. The non-appportionment result can be defeated by an express contract.



# THE COMMON LAW

## E. Consents from Surface Owners?

1. Vertical well – Lessee can use as much of the surface as is reasonably necessary as long as the lessee is:
  - a. Not negligent
  - b. Exercises “due regard” for the surface owner’s existing uses.
  - c. *Ball v. Dillard; Getty Oil Co. vs. Jones*



# THE COMMON LAW

## E. Consents from Surface Owners?

2. Horizontal well - If an operator intends to use the surface of a tract which he does not intend to pool, then he must obtain that surface owner's consent prior to commencing drilling operations.

*Robinson v. Robbins Petroleum Corp.*



# THE COMMON LAW

## F. Waiver of Partitioning Pooled Units

A joint owner of an interest in real property has an absolute right to partition that interest. In the case of producing minerals, partition must be by sale, rather than by partition in kind. Notwithstanding the absolute right to partition, parties can agree to waive that right. In *MCEN 1996 Partnership v. Glassell*, the Corpus Christi Court of Appeals held that, as a matter of law, the cumulative provisions in the pooling agreements at issue waived the right to partition.



# THE COMMON LAW

## G. The Consequence is a Cross-Conveyance?

*Veal v. Thomason* dealt with determining who were necessary parties in pooling litigation. No Texas case has confirmed that actual title was cross-conveyed. Cross-conveyance is a theory, not a reality.



# THE CONTRACT

A. A Texas Court will interpret an unambiguous oil and gas lease provision strictly based upon the words actually used, not upon what the parties may have intended but did not express.

*Heritage Resources, Inc. v. NationsBank.*

Absent express authority, a lessee has no power to pool the lessor's interest with the interest of others.

*Southeastern Pipeline Co. v. Tichacek.*



# THE CONTRACT

- B. A Lessee's Pooling Authority is limited to the express terms contained in the oil and gas lease. *Exxon Corp. v. Atlantic Richfield Co.* A typical pooling clause addresses the following issues:
1. Authority to pool leased land with other lands for the reasons stated.
  2. Identifies acreage limits for pooling for oil and for gas.
  3. Allows "governmental regulation" to increase acres that can be pooled.
  4. The act of pooling requires the lessee to record a written designation of unit in the county of the land leased.
  5. Once the unit designation is recorded, operations and production from the drillsite are considered operations and production from the non-drillsite tracts.
  6. Each royalty owner pooled is entitled to receive royalty based upon the fraction composed of the net mineral acres contained in his tract divided by the total mineral acres pooled.



# THE CONTRACT

C. The granting of pooling authority in the lease is interpreted broadly, *Tiller v. Fields*, but the exercise of that authority is often interpreted strictly, *Jones v. Killingsworth*. The best solution is a well-drafted pooling clause granting the lessee broad powers and wide discretion. See Texas Exxon Lease attached as Exhibit A.



# THE CONTRACT

## D. Entirety Clause – Negates the non-apportionment rule.

Royalty is paid on a lease basis, not a tract basis.

*Thomas Kilcrease Foundation v. Stanolind Oil & Gas Co.*

Most current lease forms do not contain an entirety clause.



# THE CONTRACT

## E. Pugh Clause/Partial Lease Termination

The rule of indivisibility requires that production from a lease, or from any land pooled with the leased land, maintains the lease in its entirety. *Mathews v. Sun Oil Co.* A “Pugh clause”, I prefer “lease termination clause”, allows a lease to partially terminate, vertically and/or horizontally, outside of producing acres and formations. *Shown v. Getty Oil Company*



# THE CONTRACT

## F. Retained Acreage Clause.

These clauses are sometimes referred to as retained acreage clauses, Pugh clauses, lease termination clauses, continuous development provisions, or release clauses. The result is that leases partially terminate vertically except for the acreage around a producing well, usually described as the acreage within a proration unit, or the number of acres required to obtain a maximum allowable.

There are no proration units where there are no special field rules or where the allocation formula does not include acreage as a factor. Therefore, in those instances, a retained acreage clause that is based upon retention of the acres within a proration unit would be considered ambiguous.



# THE CONTRACT

## F. Retained Acreage Clause.

Do not confuse the acres a lessee can pool, which is determined by the authority granted in the pooling clause of the lease, with the acres the lessee can retain after the completion of the continuous drilling program, which is determined by the retained acreage clause.



# THE CONTRACT

## G. JOA as Pooling Agreement (creates a “working interest unit”)

A JOA is a contract between the leasehold owners of leases covering one or more tracts whereby they agree how they will participate in the cost of drilling a well and in the proceeds from production of the well.

Typically a JOA covers the land upon which the first well is drilled upon the leases. However, a JOA can cover the lands covering the drilling of multiple wells, and this is called a “working interest unit”. A JOA does not pool royalty. *Gillring Oil co. v. Hughes*



# THE CONTRACT

## H. Benefits of Successful Pooling

1. Each lessor relinquishes his right to have his tract developed and to receive all royalties from his tract.
2. Commencement of drilling and other operations on one tract benefit all tracts, and excuse the payment of delay rentals.
3. Production on any tract extends the primary term of all leases pooled.
4. Wells may be located within the pooled unit without respect to the individual property or lease lines and the lessee is relieved of its obligation to drill offset wells within the pooled acreage.



# THE CONTRACT

## I. Examples of Unsuccessful Pooling.

1. When lease is pooled for gas, completion of an oil well is not a “dry hole”. *Sunac Petroleum Corp. v. Parkes*.
2. Non-drillsite mineral owners or lessee cannot ratify a pooled unit after a successful well has been completed. *Fletcher v. Ricks Exploration*.



# THE COMMISSION

## A. Spacing Requirements – Rule 37

Spacing determines the minimum distance a well must be from tract and lease lines. If special field rules have been adopted, the field rules will prescribe the minimum distance. In the absence of special field rules, the statewide spacing rule is 467' from the property, lease or subdivision line, and at least 1,200' between wells. Acreage is assigned to a well in accordance with the spacing regulations to form a “drilling unit”, which must be designated before a well may be drilled.



# THE COMMISSION

## B. Density Requirements – Rule 38

Density rules prescribe the number of acres attributed to a well after it has been drilled, thus creating a “proration unit”. Typical density rules would require 40 or 80 acres for an oil well and 320 or 640 acres for a gas well. A “proration unit” has no title consequence unless it is included as a limitation in a retained acreage clause.



# THE COMMISSION

## C. Right of way strip does not destroy contiguity - Rule 39.

Drilling and proration units for individual wells shall consist of tracts which are contiguous. If the tracts are separated by along narrow strip, such as a road or railroad, the operator can obtain an exception.



# THE COMMISSION

## D. Production Allowables – Rule 40

The term “production allowable” refers to the quantity of hydrocarbons a well may produce consistent with applicable field rules. The RRC regulates allowables in order to control the rate of production from a field. Typically, oil and gas wells are allowed to be produced at a 100% allowable (Absolute Open Flow, or AOF). The most frequent basis used for determining the allowable is productive surface acres. Thus, an operator must first designate the proration unit describing the acreage assigned, then certify that the acreage is productive, before receiving the wells production allowable.



# THE COMMISSION

## E. Drilling Unit – Proration Unit – Pooled Unit

The grant of a permit to drill a well, which creates a drilling unit, does not pool separately owned tracts. The designation of a proration unit does not create a pooled unit. Pooling is a matter of contract authorized and limited by the pooling clauses of the leases pooled. The RRC has no authority to determine property rights. *Jones v. Killingsworth*. A case that discusses these differences is *Whelan v. Manziel*.



# The Commission

## F. Horizontal Wells – Rule 86

My paper contains a summary of Rule 86 as originally issued.



# CATASTROPHES

## A. Timely recording perpetuates the non-drillsite tracts.

In the usual event where the pooling clause does not provide the time when the pooling becomes effective, pooling is effective when the pooling instrument is recorded. *Sauder v. Frey*. If the pooling clause does not require that it be recorded, it is effective upon execution. *Tiller v. Fields*. I recommend that the pooling clause state that it is effective upon the date provided in the pooling instrument.



# CATASTROPHES

B. Designation of Unit must be executed by the person authorized.

The only person expressly authorized is the lessee. If someone other than the lessee executes the pooling instruments, the pooling instrument should reflect that the third party is acting as the agent for a lessee.

*Pampell Interest, Inc. v. Woole.*



# CATASTROPHES

## C. Government Regulations may “prescribe” and/or “permit”.

Field Rules sometimes provide that they “prescribe” (require) so many acres be attributed to a well, while the lessee is “permitted” (allowed) to attribute additional acreage to a well. Be aware that many pooling clauses allow the lessee to pool as “prescribed” by the RRC, but not as “permitted” by the RRC.

*Jones v. Killingsworth*



# CATASTROPHES

## D. Some “good faith/bad faith” issues.

1. Cannot include condemned land. *Amoco Production Co. v. Underwood*.
2. Cannot gerrymander. *Circle Dot Ranch, Inc. v. Sidwell Oil & Gas, Inc.*,
3. Cannot ignore geology. *Elliott v. Davis*.



# CATASTROPHES

## E. Duty of mineral owner/lessee to unleased mineral owner.

1. Drillsite tract – carry unleased mineral owner in drillsite until payout. *Superior Oil Co. v. Roberts*.
2. No duty to offer unleased mineral owner right to participate in a pooled unit. *Donnan v. Atlantic Richfield*.
3. Non-drillsite tract – can be ignored after well completed. *Fletcher v. Ricks Exploration*.



# CATASTROPHES

## F. Duty to drillsite NRPO

Cannot be pooled without owners consent. *Brown v. Smith*. Can ratify lease or pooling agreement, or not ratify anything, based upon its own self interest. *MCZ, Inc. v. Triolo*.



# CATASTROPHES

## G. Duty to Non-Drillsite NPRO.

Allowed to ratify at any time. May or may not receive proceeds from first production. *DeBenavides v. Warren*.

NPRO nearly always wins.

# CALCULATING ROYALTY WHERE NPRI IN DRILLSITE

Lease – 3/16 R

NPRI of 1/16 of O&G  
in drillsite

## No Ratification

MO –  $3/16 \times 1/4$  (TF) =  $3/64$

NPRI –  $1/16 \times 8/8 = 4/64$

R paid to MO = 0

•	

## Ratification

MO –  $3/16$  of  $1/4$  (TF) =  $3/64$

NPRI –  $1/16$  of  $1/4$  (TF) =  $1/64$

R paid to MO 2/64



# CALCULATING ROYALTY WHERE NPRI IN DRILLSITE

Lease – 3/16 R

NRPI of 1/16 of the R  
in drillsite

•	

## No Ratification

$$\begin{aligned}
 \text{MO} - 3/16 \times 1/4 \text{ (TF)} &= 3/64 \\
 \text{NPRI} - 1/16 \times 3/16 &= 3/256 \\
 \text{R paid to MO} - 3/64 \text{ (-)} &= \underline{9/256} \\
 &= 12/256 \text{ (3/64)}
 \end{aligned}$$

## Ratification

$$\begin{aligned}
 \text{MO} - 3/16 \text{ of } 1/4 \text{ (TF)} &= 3/64 \\
 \text{NPRI} - 1/16 \text{ of } 3/64 &= 3/1024 \\
 \text{R paid to MO} - 15/16 \text{ of } 3/64 &= \underline{45/1024} \\
 &= 48/1024 \text{ (3/64)}
 \end{aligned}$$



# **In An Election Year, Support the oil and gas Industry**

**Learn**

**Listen**

**Lampon/Harpoon**



# THANK YOU

## QUESTIONS?

**George Snell**

Steptoe & Johnson PLLC

[george.snell@steptoe-johnson.com](mailto:george.snell@steptoe-johnson.com)