

Pooling and Fieldwide Units

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Pooling

Pooling is defined as the bringing together of small tracts or fractional mineral interests in one or more tracts to form a drilling and production unit for a well under applicable spacing rules.

Pooling is distinguished from the related concept unitization.

Pooling is associated with a single well.

Unitization relates to joint operations over an entire field and involves multiple wells.

There are two kinds of pooling — compulsory (forced) pooling and voluntary pooling, which raise different legal issues.

Forced or compulsory pooling (terms used interchangeably) is another form of governmental regulation.

The underlying purpose of compulsory pooling is to.

- prevent waste; and
- protect correlative rights.

The basic concept of compulsory pooling is simple: If parties are in a situation where pooling would be desirable, but cannot work out a deal for themselves, the state will work out a deal for them by compulsory pooling.

Texas has long adhered to an anti-forced pooling policy.

Forced Pooling in Texas

Forced Pooling in Texas - the Texas forced pooling statute is similar to the statutes of most states.

The Texas Railroad Commission has authority to issue forced pooling orders.

A mineral interest owner who is force pooled in Texas has essentially the same options as mineral owners in other states.

- participate;
- lease; or
- take a carried interest with penalty.

Both the Texas courts and legislature are strongly against compulsory pooling and limit the practice.

- The Texas statute subjects the operator to more preconditions and to greater limitations in forced pooling situation than do other states.
- The Texas forced pooling statute, called Mineral Interest Pooling Act (MIPA), has been characterized as an Act to encourage voluntary pooling rather than a true compulsory pooling act.

Forced Pooling in Texas (Continued)

Limitations to forced pooling in Texas

Prospective Application - If the reservoir in which a well is being drilled was discovered before March 8, 1961 — the date of Normanna decision — the forced pooling statute does not apply.

- Precludes forced pooling in many of the major fields in Texas — most of the fields in the Permian Basin, the East Texas Field and most of the fields along the Texas Gulf Coast.

The Railroad Commission Cannot Compel Compulsory Pooling on Its Own Motion.

- Forced pooling has to be initiated by mineral interest owners.
- Thus, if A and B own adjoining 320-acre tracts, they can develop their tracts individually if they so choose, even though the spacing for gas in the area is 640 acres.
- The RRC can not compel them to pool.

Fair and Reasonable Offer Requirement.

- The MIPA requires that an applicant for forced pooling "set forth in detail the nature of the voluntary pooling offers made to the other interest owners in the proposed unit."
- The MIPA requires the RRC to dismiss the application unless it finds that fair and reasonable offers were made.
 - Unless there is a finding of fairness by the RRC, the application will not be granted.
 - The applicant will not be granted a forced pooling order unless he shows that he has exhausted all efforts to reach voluntary agreement.
 - Fairness is judged from the standpoint of the party being force pooled at the time of the offer to voluntary pool.

In Texas the bottom line is if the parties cannot work out a deal for themselves, the state will work out a deal for them, but only as a last resort.

Forced Pooling in Texas (Continued)

Example showing applications of compulsory pooling in Texas

Oil and gas was hypothetically first discovered in the Austin Chalk Field in November 1960. A and B own adjoining 20-acre tracts which they bought prior to discovery. The spacing rules provide for one well per 40 acres.

Relative to any well or wells drilled on the properties owned by A and B are the following statements yes or no?

- A and B can each obtain drilling permits.
- Yes. They qualify for the Rule 37 exceptions to prevent confiscation.
- Neither A nor B can obtain drilling permits because of the voluntary subdivision rule.
- No. The tracts were created before oil was discovered in the area.
- If A and B each drill wells and obtain production, the allowables for each well will be fixed at a rate that will enable recovery of drilling costs plus a reasonable profit.
- No. That is the old allowable rule. It was changed in the 1960s to the fair share rule. Therefore, today they should not drill if not economical on a small tract.
- A and B can be force pooled.
- No. The field was discovered prior to the March 8, 1961 MIPA date.

Forced Pooling in Texas (Continued)

The Muscle-in Provision of MIPA.

There is a provision in the MIPA which enables a small tract owner, who has no other small tracts with which he can pool, to force himself into a unit. Called the "muscle-in" provision.

"The Commission shall not require the owner of a mineral interest, the productive acreage of which is equal to or in excess of the standard proration unit for the reservoir, to pool his interest with others, unless requested by the holder of an adjoining mineral interest, the productive acreage of which is smaller than such pattern, who has not been provided a reasonable opportunity to pool voluntarily."

Voluntary Pooling in Texas (Continued)

Voluntary Pooling raises issues which are quite different from the issues raised in forced pooling.

Fundamentally, voluntary pooling there must be mutual assent just as in a contract. Without the Lessor's consent, the Lessee cannot pool the Lessor's interest.

The overriding considerations in voluntary pooling are: (1) Why do it? (2) How is it done? and (3) What are the effects?

Why Pool? -There are three good reasons to pool acreage voluntarily:

- Small Tract — The tract or the acreage controlled by the operator is too small to comply with the spacing rules.
- Geological Reasons — The operator needs to pool to locate the well over the reservoir.
- Business Flexibility — This is a catchall term that covers a variety of situations where it makes good business sense for the reasonable prudent operator to pool. He may want to pool to get a larger unit for purposes of increasing his allowable, he may want to pool in order to hold a number of leases by drilling a single well, et cetera.

How to Accomplish Voluntary Pooling - The operator or Lessee must obtain the Lessor's consent to pool. There are three ways to obtain the Lessor's consent to voluntarily pool:

- Community lease,
- Separate pooling agreement, and
- Lease pooling clause.
 - A community lease is a single lease document that covers two or more separate tracts of land.
 - Example, if one lease document describes two adjoining tracts: Wacre, owned by X, and Bacre, owned by Y.
 - Both X and Y both sign the document, it is a community lease and Bacre and Wacre have been pooled as a matter of law.

Voluntary Pooling in Texas (Continued)

Separate Pooling Agreement.

- All parties who have interests in the minerals underlying the tracts to be pooled enter into a specific agreement relating to pooling.
- Agreement is separate from other agreements they might have (the Oil and Gas Lease), they have pooled their tracts.
- Pooling by separate agreement often occurs in deals between large oil companies.
- Separate agreement is true voluntary pooling
- Lease Pooling Clause - the most common way that voluntary pooling occurs today is through a pooling clause in the lease (pooling by delegation).
- An example of a lease pooling clause found in ¶ 4 of the Lease Form, attached in the Lease Section of this Workbook.
- The distinction between the separate pooling agreement and a lease pooling clause, is important because it explains why pooling clauses are strictly construed against the Lessee.
 - Gives the Lessee power to pool the Lessor's interest.
 - Gives the Lessee a power of attorney to act for the Lessor.
 - Gives the Lessee the option of exercising or not exercising the authority delegated to him by the clause.
 - Gives the Lessee flexibility and enables him to hold additional leases and acreage through pooling.
 - Modifies both the habendum clause and the royalty clause.
- The Lessee will try to get this clause in the lease when the lease is initially taken.
- If the Lessee does not get the Lessor's consent to pool when he takes the lease and has to subsequently get the Lessor's permission to pool, he will probably have to pay for it.
- The Lessor would prefer the lease not have a pooling clause, because it gives value to the lease like the amount of the royalty and bonus, limitations on surface use that knowledgeable lessors negotiate before they sign leases.

Voluntary Pooling in Texas (Continued)

The Pugh Clause is a negotiated compromise, between the Lessee who wants a pooling clause in the lease and the Lessor who does not.

The Pugh clause modifies the pooling clause.

There are several variations of Pugh clauses, but the basic idea is that the Pugh clause provides that operations or production from the pooled unit will not preserve the whole lease.

- Operations or production will only preserve that portion of the lease which covers land in the pooled unit.

A Pugh clause severs the unpooled acreage from the pooled acreage.

- Valuable clause for the Lessor.
- The more acreage Lessor has to lease, the more important it is for him to have a Pugh clause.
- The Pugh clause was named for Lawrence Pugh, a Louisiana lawyer, who invented the clause.

Voluntary Pooling in Texas (Continued)

Requirements for Valid Pooling Under a Lease Pooling Clause - When a Lessor challenges the Lessee's exercise of his pooling authority, the issues most likely to arise are.

- Did the Lessee strictly comply with the lease terms/act precisely according to the pooling clause?
- Did the Lessee pool in good faith?

Strict Compliance.

- The terms of an oil and gas lease are strictly construed against the Lessee.

Good Faith.

- The good faith requirement is judicial gloss established by the Texas courts.
- Good faith is a fact question.
- Burden is on the Lessor to show bad faith.
- Determination of the good faith issue depends on a number of factors.
- Examples - excessive gerrymandering, pooling known unproductive acreage with potentially productive acreage, no plans for further development, pooling just prior to expiration of a lease's primary term.
- The Lessor has to show that the operator failed to act like a reasonable prudent operator.
- The pooling was not done for a valid business, geological or regulatory reason.
- The operator acted unreasonably under the circumstances.

Voluntary Pooling in Texas (Continued)

Effect of pooling on the severed NPRIs

- In Texas for pooling purposes a NPRI is an independent interest which is not bound by a pooling clause in a lease which the holder of the NPRI did not execute.
- NPRIs can be pooled, but the Lessee has to get the consent of the owners of the NPRIs to pool their interests.
- This is done by getting them to ratify the lease.

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