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Gina S. Warren

Texas A&M University School of Law, gswarren@law.tamu.edu

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POOLING CLAUSES AND STATUTES

PROFESSOR GINA S. WARREN

Texas A & M University School of Law

1515 Commerce Street

Fort Worth, Texas 76102

817.212.3935

gswarren@law.tamu.edu

State Bar of Texas

OIL, GAS & ENERGY RESOURCES 101

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CHAPTER 5

Gina S. Warren

Associate Professor of Law
Texas A&M University School of Law
1515 Commerce Street
Fort Worth, TX 76102
phone: (817) 212-3935
gswarren@law.tamu.edu

GINA S. WARREN - BACKGROUND, EDUCATION AND PRACTICE

Professor Gina S. Warren became a member of the faculty in 2011, where she currently teaches Oil & Gas, Energy Law, Climate Change & Energy, and Civil Procedure. Professor Warren previously taught Civil Procedure and Energy Law as a visiting professor at Duquesne University School of Law and taught a summer seminar on U.S. energy law at the University of Cologne in Cologne, Germany. Before entering academia, Professor Warren was at Perkins Coie, LLP, a prominent international law firm, based in Seattle, Washington. She was a litigator in practice, with an emphasis in energy and utility law.

Professor Warren writes and publishes in the area of sustainable energy development.

Professor Warren received her B.S. in Psychology from the University of Arizona followed by her J.D. from Rutgers University School of Law. After graduating from Rutgers, Professor Warren completed a clerkship for the Honorable Michael Winkelstein of the Appellate Division of the Superior Court of New Jersey. She is admitted to practice in Pennsylvania, New Jersey, the U.S. Virgin Islands, and Washington.

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POOLING CLAUSES AND STATUTES

I. INTRODUCTION

Pooling is a tool used to bring together small or irregular tracts of land or mineral interests to form one drilling unit for the purposes of oil or gas production. In general, pooling can be accomplished in a variety of ways, including separate pooling agreements, community leases, voluntary pooling clauses within leases, and compulsory pooling statutes. This article will focus on voluntary pooling lease clauses and compulsory pooling statutes.

This article will discuss the requirements for valid pooling under a voluntary lease provision and look at the remedies available for invalid or improper pooling. It will analyze the effect of pooling on the Royalty Clause and the Habendum Clause, and it will discuss anti-dilution and Pugh clauses, which can place further limitations on a lessee's discretion to pool.

Finally, this article will provide a brief overview of compulsory pooling statutes and look at how Texas' Mineral Interest Pooling Act differs from compulsory pooling statutes utilized in a majority of the oil and gas producing states.

II. VOLUNTARY POOLING CLAUSES

In Texas, the most common way to pool oil and gas interests is through use of a voluntary pooling clause in a lease. "Voluntary pooling is an important tool for promoting conservation, avoiding unnecessary drilling of offset wells, sharing risks, and minimizing expenses." Mitchell E. Ayer, *Navigating the Pooling Clause Waters: New and Recurring Issues*, 53 Rocky Mtn. Min. L. Inst. 33-1 (2007). Further, with the increased use of drilling techniques like horizontal drilling and hydraulic fracturing, drilling and completing wells is an increasingly costly venture. *Id.* Consequently, pooling is more vital than ever to avoid the costs of unnecessary wells. *Id.*

A pooling clause can be used to facilitate pooling for horizontal wells as well as vertical wells. Sample pooling clause language is as follows:

Lessee is hereby granted the right, at its option, to pool or unitize any land covered by this Lease with any other lands covered by this Lease, and/or with any other land, lease, or leases, as to any or all minerals or horizons, so as to establish units containing not more than 80 surface acres, plus 10% acreage tolerance; provided, however, units may be established as to any one or more horizons, or existing units may be enlarged as to any one or more horizons, so as to

contain not more than 640 surface acres plus 10% acreage tolerance, if limited to one or more of the following:

- a) gas, other than casinghead gas,
- b) liquid hydrocarbons (condensate) which are not liquids in the subsurface reservoir,
- c) minerals produced from wells classified as gas wells by the conservation agency having jurisdiction.

If larger units than any of those herein permitted, either at the time established, or after enlargement, are required under any governmental rule or order, for the drilling or operation of a well at a regular location, or for obtaining maximum allowable from any well to be drilled, drilling, or already drilled, any such unit may be established or enlarged to conform to the size required by such governmental order or rule. Any operations conducted on any part of such unitized land shall be considered, for all purposes, except the payment of royalty, operations conducted upon said land under this lease. A unit once established hereunder shall remain in force so long as any lease subject hereto shall remain in force. (Producers 88 (7-69) Paid-Up Lease with 640 acre Pooling Provision).

A pooling clause will generally revise a lease in three ways, which will be discussed in detail below. First, it expands the granting clause by giving a lessee the authority to determine whether to pool. Second, it revises the royalty clause because the lessor agrees to accept a royalty proportionate to her acreage within the pooled unit. Third, it expands the habendum clause by allowing drilling operations on any part of the pooled unit to have the same effect as if drilling operations were commenced on the leased area.

Though this article does not focus on the relationship between surface owners and mineral interest owners, it is important to note that valid pooling will result in the lessee having the right to reasonably use the surface of the entire pooled unit for the purpose of oil and gas exploration, development, and production. In *Key Operating & Equipment, Inc. v. Hegar*, No. 01-10-00350-CV, 2014 WL 2789933 (Tex. Jun. 20, 2014), two tracts of land, the Curbo tract and the Richardson tract, were pooled in order to form one single drilling unit. *Id.* Key was only operating on the Richardson tract. *Id.* However, in order to access the Richardson tract, Key used a roadway across the Curbo tract. The surface owner of the Curbo tract, Mr. Hegar, filed suit against Key for trespass and sought termination of Key's use of the roadway across his surface. *Id.* The Texas Supreme Court, reversing the appellate decision, stated that the "primary legal consequence of pooling is that

‘production and operations anywhere on the pooled unit are treated as if they have taken place on each tract within the unit.’” *Id.* at 3–4. When the two tracts were pooled together, they assumed a single identity, providing Key with the right to access the Richardson tract via the roadway located on the Curbo tract. For leases without pooling restrictions, the lessee has the lawful authority to use a road across a non-producing tract in a pooled unit.

A. Effect of Amending the Granting Clause - Requirements for Valid Pooling

A pooling clause expands the granting clause by giving a lessee the authority to determine whether to pool. This authority, however, is not unfettered. Many disputes have arisen through the years as to whether a lessee has properly exercised his discretion and authority under a pooling clause. In general, there are two requirements for valid pooling under a lease clause. First, the exercise of pooling must be done in strict accordance with the terms of the lease. Second, it must be done in good faith.

1. In Strict Accordance with the Lease Language.

While a lessee generally has broad discretion to determine whether to pool its lessor’s interests, the lease language will be construed very strictly. For example, in *Jones v. Killingsworth*, 403 S.W.2d 325 (Tex. 1965), the lease in question contained a clause which allowed the lessee to create pooled units for oil not to substantially exceed 40 acres. However, the lease also granted the lessee the power to increase the size of the unit if it “conform[ed] substantially in size with those *prescribed* by governmental regulations.” *Id.* at 327 (emphasis added). The lessee pooled the lessor’s tract with other interests to create a 176.86 acre pooled unit. The Commission’s rules for this particular field *prescribed* oil units of 80 acres, but *permitted* units of up to 160 acres. The court held that, under the lease terms, the pooled unit could be no greater than 80 acres as *prescribed* by the Commission. Specifically, the court reasoned that the fact that the Commission *permitted* units of up to 160 acres in the field did not give the lessee the right to pool the lessor’s interests to create a 160-acre unit. Rather, the lease terms allowed the lessee to enlarge a unit above 40 acres only to the extent necessary to conform to the Commission’s field rules: here 80 acres. As a result, the lessee had pooled the lessor’s interests without proper authority. The lease’s habendum clause did not extend the lease beyond the primary term, and the lease terminated. *Id.* at 328.

Likewise, in *Sauder v. Frye*, 613 S.W.2d 63 (Tex. App.—Fort Worth 1981, no writ), the oil and gas lease required the lessee to execute and record in the county where the pooled units were created, an instrument identifying the units. After the expiration

of the primary term, the lessee executed and filed such an instrument in the proper county. The court held that the lease terminated under its own terms because the lessee failed to file the instrument prior to the expiration of the primary term, and that the lease contained no other clauses that worked to maintain the lease into the secondary term.

In a 2012 Texas appeals case, however, the court held that a lessor may, under certain circumstances, waive her right to claim a breach of a lease’s pooling provision. In *Ohrt v. Union Gas Corp.*, 398 S.W.3d 315 (Tex. App.—Corpus Christi 2012, pet. denied), the lessors alleged that the lessees failed to include all of the lessees’ acreage in the pooled unit in accordance with an amendment to the lease and that the lessees drilled beneath the lowest permissible depth. However, the evidence showed that throughout the leasing and subsequent amendment process, the lessors had assistance of counsel who reviewed the leases and monitored the formation of the pooled units. The lessors also executed and returned the division orders. Also, the lessors collected and cashed royalty checks from the pooled unit for several months. The jury found that the lessors’ conduct, regardless of any breach on the lessees’ part, estopped the lessors from asserting an action for breach of the lease’s terms due to the lessors’ waiver and ratification. The appellate court affirmed.

2. In Good Faith.

Incumbent on all parties to a contract is the implied duty to act in good faith. Likewise, a lessee’s decision to utilize the pooling clause must be done in good faith. The question of whether the lessee acted in good faith is one of fact, and the inquiry is whether a reasonably prudent operator would exercise its option to pool under the circumstances, taking into account the interests of both the lessee and the lessor. *Circle Dot Ranch, Inc. v. Sidwell Oil & Gas, Inc.*, 891 S.W.2d 342 (Tex. App.—Amarillo 1995, writ denied).

In *Amoco Production Company v. Underwood*, 558 S.W.2d 509 (Tex. Civ. App.—Eastland 1977, writ ref’d n.r.e.), various lessors executed eight oil and gas leases covering approximately 2,252 acres, portions of which were subsequently included in the pooled unit. All of the leases contained voluntary pooling clauses. Approximately six months prior to the expiration of the primary terms of the majority of the leases, the lessee began drilling operations. A gas well was ultimately completed two days before the expiration of the primary terms of the majority the leases. In forming a drilling unit of approximately 688 acres, the lessee:

- a) excluded a portion of the acreage of one of the pooled tracts from the pooled unit, although records indicated that the excluded

- acreage was probably productive; and
- b) included acreage from one of the tracts in the pooled unit despite the fact that the productive zone was probably below the depth where the lessee had completed its well.

The lessor contended that the lessee gerrymandered the drilling unit to save the leases by production beyond the primary term. The court agreed, holding that under these facts, the lessee did not establish the unit in good faith.

Likewise, in *Mission Resources, Inc. v. Garza Energy Trust*, 166 S.W.3d 301 (Tex. App.—Corpus Christi 2005), *rev'd on other grounds*, 268 S.W.3d 1 (Tex. 2008), the lessors' expert testified that the lessee formed a pooled unit in a manner that financially harmed the royalty interest owners while benefitting the lessee, and that there were other ways to pool the unit to avoid financial harm to the royalty interest owners. The court held that, under the facts, the lessee failed to consider the interests of the royalty owners in addition to its own. Therefore, more than a scintilla of evidence existed to sustain the trial court's conclusion that the lessee had pooled the unit in bad faith.

3. Remedies for Invalid Pooling/Improper Exercise of Pooling Power.

If the unit is not pooled in good faith or in accordance with the lease terms, "production will be considered to take place only on the actual tract upon which it occurs, and production from a unit well will not maintain off-site leases." *Southeastern Pipe Line Co. v. Tichacek*, 997 S.W.2d 166, 170 (Tex. 1999). Furthermore, the remedy for bad faith pooling in a cross-conveyance state (such as Texas) is to undo the unit and return the parties to their original positions. Jonathan D. Baughman, *Navigating the Pooling Clause Waters: New and Recurring Issues*, 53 Mtn. Min. L. Inst. 33-1 (2007).

B. Effect of Amending the Royalty Clause

Generally, absent an agreement to the contrary and regardless of the location of the well, all royalty interest owners in the pooled unit subject to a lease will share in production in proportion to their acreage within the pooled unit. *London v. Merriman*, 756 S.W.2d 736, 739 (Tex. App.—Corpus Christi 1988, writ denied) ("In other words, all royalty interest owners in the land subject to the lease share in production no matter where the well is drilled on the leasehold.").

If the lease provides for a specific formula for payment of royalties for pooled units, however, that formula will control. In *Shell Oil Co. v. Ross*, 357 S.W.3d 8 (Tex. App.—Houston [1st Dist.] 2010),

rev'd on other grounds, 356 S.W.3d 924 (Tex. 2011), the subject lease contained the following provision:

Any operations conducted on any part of such unitized land shall be considered, for all purposes, except for the payment of royalty, operations conducted under this lease. There shall be allocated to the land covered by the lease included in any such unit that proportion of the total production of unitized minerals from wells in the unit, after deducting any used for lease or unit operations, which the number of surface acres in the land covered by this lease included in the unit bears to the total number of surface acres in the unit. The production so allocated shall be considered for all purposes, including the payment or delivery of royalty, overriding royalty, and any other payments out of production, to be the entire production of unitized minerals from the portion of said land covered hereby and included in such unit in the same manner as though produced from said land under the terms of this lease.

Additionally, the lease required the lessee to pay royalties based on the amount the lessee realized from the sale of gas at the mouth of the well. Instead, however, the lessee paid royalty to the lessor based on a weighted average taking into account the amount realized by other working interest owners as well, ultimately to the benefit of the lessee. The court held that the lessee breached the express terms of the lease by using the weighted average calculation.

Of note, while a nonparticipating royalty interest ("NPRI") owner's interests can be pooled without express consent, Texas courts have held that an NPRI owner is entitled to her full royalty interest instead of a proportionate share of the pooled unit, absent an NPRI owner's joining in or ratifying the lease (or expressly consenting in the instrument creating the NPRI). In *Brown v. Smith*, 174 S.W.2d 43 (Tex. 1943), the grantor conveyed her interest in a certain tract of land, reserving for herself a one-thirty-second (1/32) nonparticipating royalty interest in the minerals conveyed. Thereafter, the grantee executed an oil and gas lease on the subject lands. The lessee drilled a producing well on the subject land, pooling the tract with others to form a unit. The grantor in the original conveyance never agreed to the pooling agreement. The court held that, if a unit well is located on a lease subject to a nonparticipating royalty, absent the NPRI owner's ratification, the NPRI owner is entitled to her full fraction of production, irrespective of the pooling provision's production allocation among the tracts.

1. Anti-Dilution Provisions.

Anti-dilution clauses are intended to protect the lessor against the possibility that only a small portion of his property will be included in a pooled unit, thereby significantly diluting his royalty. As such, anti-dilution clauses generally require a lessee to pool a large portion of, or the entirety of, the leased premises. Sample clause language is as follows:

[I]f any pooled unit is created with respect to any well drilled on the land covered hereby, at least sixty percent (60%) of such pooled unit shall consist of the land covered hereby.

Browning Oil Co., Inc. v. Luecke, 38 S.W.3d 625, 637 (Tex. App. 2000—Austin, pet. denied).

In *Browning Oil Co., Inc. v. Luecke*, the parties executed an oil and gas lease prior to the industry's pervasive use of horizontal wells. A lease clause provided that, should the lessees exercise their option to pool the lessor's land, at least 60% of the resulting pooled unit must consist of the leased lands. The lessees pooled the lessor's interests in a unit, but the lessor's land comprised less than 60% of the unit. The lessees offered three arguments as to why the lessee should be excused from complying with the lease's express terms. First, "the lessees argue[d] that because the horizontal drainholes penetrated existing pooled units, they were required to include the acreage from those existing units in the purported horizontal units, rendering it impossible to limit the size of the purported horizontal units to eighty acres" (the amount that would have been required to meet the 60% requirement). Second, the lessees argued that no reasonably prudent operator would have drilled a horizontal well on an eighty-acre unit, therefore excusing the lessee from complying with the lease's anti-dilution provisions. Third, "the lessees argue[d] that the field rules require all points on the drainholes be included in the units, and because the drianhole displacement exceeded eighty acres, it was impossible to create an eighty acre unit." The court held that, under the lease's express terms, the lessees breached the lease by creating a pooled unit, less than 60% of which consisted of the lessor's lands. Importantly, the court held that the lessees' drilling of a horizontal well in no way excused the lessees from complying with the lease's express terms.

In *Sabre Oil & Gas Corporation v. Gibson*, 72 S.W.3d 812 (Tex. App.—Eastland 2002, pet. denied), Sabre Oil Company ("Sabre") was assigned certain portions of a 157-acre oil and gas lease. Sabre pooled its interests in the 157-acre tract (only a portion thereof) with other surrounding tracts. The lessors sued claiming that Sabre had breached the terms of the lease. The lease provided that the lessee must first attempt to pool all of the lessors' lands. Additionally,

the lease contained a clause allowing the parties to assign any portion of their rights, title, and interest in the lease at any time. The court held that Sabre included in its unit all of the property owners' tracts, to which Sabre had acquired rights through the original lessee's partial assignment of interests in several, but not all, of the lessors' tracts. The court found that the lessors' interests were not diminished (in violation of the anti-dilution clause) by the pooling of their lands with other lands to form the unit.

C. Effect of Amending the Habendum Clause

Proper pooling and drilling operations on any portion of the pooled unit will have the effect of amending the Habendum clause. Generally, to maintain a lease into the secondary term, the lessee must achieve production in paying quantities from a well drilled on the leased land. With valid pooling, however, production from any portion of the pooled land (even if not on the lessor's land) will work to keep the lease in effect, as if the well were actually drilled on the lessor's land. *Friedrich v. Amoco Prod. Co.*, 698 S.W.2d 748, 752 (Tex. App.—Corpus Christi 1985, writ ref'd n.r.e.). The effect is that the pooling clause functions as a savings clause. See Laura H. Burney, *The Texas Supreme Court and Oil and Gas Jurisprudence: What Hath Wagner & Brown v. Sheppard Wrought?*, 5 Tex. J. Oil Gas & Energy L. 219, 224 (2009-2010).

1. Pugh ("Freestone Rider") Clauses.

Pugh clauses are used to prevent undeveloped leased acreage from being held by a producing well on a pooled unit. In essence, "[t]he Pugh clause was created to protect the lessor from the concern of having the entire leasehold held by production from a very small pooled area." *El Paso Prod. Oil & Gas v. Texas State Bank*, No. 04-05-00673-CV, 2007 WL 752209 (Tex. App.—San Antonio Mar. 14, 2007, pet. denied). The Pugh clause limits the area saved by pooling, if any, to that included in the pooled area and not to the entirety of the leased land. Aloysius A. Leopold, *Texas Practice Series: Land Titles and Title Examination* § 23.35 (3d ed. 2013). As such, the balance of the leased acreage will still be subject to the other provisions of a lease, and it will not be protected or extended by pooling. *Id.* Sample clause language is as follows:

Notwithstanding anything to the contrary herein contained, drilling operations on or production from a pooled unit or units established under the other provisions of this lease, embracing land covered hereby and other land, shall maintain this Lease in force only as to land included in such unit or units. The Lease may be maintained in force as to

the remainder of the land covered hereby and not included in such unit or units in any manner herein provided for, including operations thereon or production therefrom.

(Addendum to Producers 88 (7-69) Paid-Up Lease with 640-acre Pooling Provision).

In addition to this standard vertical Pugh clause, which divides the leasehold strictly on the basis of the surface acreage included in a well spacing unit, a lease may also contain a Pugh clause that divides the leasehold based on the strata, reservoir or depth from which oil and gas is produced. A sample clause is as follows:

After expiration of the primary term, this lease will terminate automatically as to all horizons situated 100 feet below the deepest depth drilled (a) from which a well located on the land or acreage pooled therewith is producing in paying quantities, or (b) in which there is completed on the land or acreage pooled therewith a shut-in gas well which cannot be produced because of lack of market, marketing facilities, or because of governmental restrictions, whichever is the greater depth.

Sandefur Oil & Gas, Inc. v. Duhon, 961 F.2d 1207, 1208 (5th Cir. 1992).

In *Friedrich v. Amoco Production Company*, 698 S.W.2d 748 (Tex. App.—Corpus Christi 1985, writ ref'd n.r.e.), the court ruled that a Pugh clause in an oil and gas lease covering producing land allows the lessor to sever any part of the leasehold which is not a part of the producing unit or for which the lessee has failed to pay delay rentals. The operation of producing wells in one drilling unit or payment of delay rentals for one drilling unit does not serve to renew an entire lease. However, in the absence of a specific reference in an oil and gas lease to a depth limit or to a specific horizontal severance Pugh clause, the general Pugh clause applies only to vertical severance. Failure of a lessee to pay delay rentals on a non-producing depth does not allow a lessor to cancel the lease as to those depths. *Id.* at 754.

Likewise, in *El Paso Prod. Oil & Gas v. Tex. State Bank*, No. 04-05-00673-CV, 2007 WL 752209 (Tex. App.—San Antonio Mar. 14, 2007, pet. denied), the court held that, based on the intent of the parties, a Pugh clause did not effect a horizontal severance as to the lands underlying the pooled units. Therefore, absent lease language to the contrary, production in paying quantities of oil or gas after the primary term from one horizon of a pooled unit works to maintain the lease as to all depths underlying the pooled lands.

III. COMPULSORY POOLING STATUTES

Compulsory or forced pooling is a regulatory mechanism, used in accordance with state conservation laws in the majority of oil and gas producing states, to prevent waste and to protect a mineral interest owner's correlative rights, which is the right to a fair opportunity to produce a fair share of the oil and gas in a common reservoir. Texas' forced pooling statute has very limited applicability; however, other states such as Oklahoma utilize compulsory pooling statutes that allow (or require) the state commission to enter an order pooling all tracts and interests within a spacing unit (either before or after drilling).

A. Compulsory Pooling in Majority States

To give you an example of the types of pooling statutes in the various oil and gas producing states, we will provide an overview of the Model Oil and Gas Conservation Act of 2004, which sets forth two alternative styles of pooling. See 2004 Model Oil and Gas Conservation Act, available at: <http://www.iogcc.state.ok.us/Websites/iogcc/docs/ModelAct-Dec 2004.pdf>.

Under the first alternative, any operations on any portion of a pooled unit will be considered operations on all of the tracts in the pooled unit. *Id.* § 11(b). To protect correlative rights, the commission is authorized to make any pooling order retroactive to the date of the first notice of hearing and may make a pooling order retroactive to the date of production of the first discovery well for the underlying reservoir. *Id.* Any pooling order shall designate an owner to act as operator of the unit. *Id.* § 11(c).

The commission will give the forced interest owners three options:

- 1) to participate and pay his proportionate share of drilling costs;
- 2) to be carried with interest/penalty if the owner cannot or will not pay the drilling costs; or
- 3) to enter into a lease.

All reasonable costs of drilling, completing, operating, and plugging and abandonment shall be shared between the owners in proportion to each interest owner's acreage contribution to the pooled unit. *Id.* Or, such costs shall be allocated on another basis approved by the commission. *Id.* To prevent waste or to protect correlative rights, the commission, at its discretion, may reallocate production and costs. *Id.* If the forced interest owner chooses to not participate and to be carried with penalty, the operator of a pooled unit may recover a carried interest owner's share of the costs of operation out of the resulting production. *Id.* § 10(d). Further, the carried interest

owner may be assessed a risk and interest penalty not to exceed 300% of the owner's share of such costs. *Id.* The 2004 Model Act also provides an Oklahoma-style alternative to the above-described option. *Id.* § 11 (Oklahoma has had some form of a compulsory pooling statute since 1935. Its current statute is quite comprehensive). In the absence of an agreement to pool between owners within a well spacing unit, and where at least one owner has drilled or proposes to drill a well on the well spacing unit, the commission shall compel pooling to prevent waste and to protect correlative rights. *Id.* §11(a). The pooling applicant shall provide all owners with proper notice of the application and hearing. *Id.* § 11(b). In the alternative, the pooling applicant shall provide interest owners with written notice by mail and publish a notice in a newspaper of general circulation. *Id.* The Oklahoma-style option also includes a provision that allows the designated operator of the pooled unit to recover a reasonable charge for supervision. *Id.* § 11(e). Should a dispute arise, the commission shall determine proper costs after notice and hearing. *Id.* The Oklahoma-style option also expressly grants the operator a lien on the oil and gas estate or rights of the other owners in the pooled unit and on their share of production from the unit to the extent that costs incurred in the development and operation of the unit are a charge against the estates or interests by order of the commission or operation of law. *Id.* § 11(f). The liens are separable as to each owner within the unit and terminate when the operator has received payment in full for the amount due under the pooling order's terms. *Id.* The commission may also require that owner or owners paying for the drilling or operation be paid in full under the terms of the pooling order and shall be entitled to production, subject to the payment of royalty. *Id.* § 11(g).

B. Compulsory Pooling in Texas

Unlike Oklahoma's compulsory pooling statute, Texas' compulsory pooling statute has limited applicability and is seldom utilized. The Mineral Interest Pooling Act of 1965 ("MIPA") was intended to solve the dilemma caused by the application of spacing and density requirements to an oil or gas field that contains many small or irregularly shaped tracts. *Superior Oil Co. v. R.R. Comm'n of Texas*, 519 S.W.2d 479, 482 (Tex. Civ. App.—El Paso 1975, writ ref'd n.r.e.). The dilemma that provided the impetus for the MIPA is as follows:

For example, when spacing patterns were set by the Railroad Commission in a field, the owner of a tract smaller than such drilling unit either would be denied a permit altogether or would be granted such a low allowable that it was not profitable to drill.

His oil, then, would be drained away and produced by others. Alternatively, if the small tract owner were granted an allowable which permitted profitable development of his tract he would drain away his neighbor's oil and gas in that he was allowed to produce more oil or gas than was in place under his tract. These problems the Act was designed to cure by providing a method by which the owners of small tracts could be forced to pool their interests into a proration unit of the size provided for the field. The owners may pool by agreement, but in the absence of their being able to agree or unwilling to have their interests pooled, one of their number can make application to the Railroad Commission under the Act and force the others to pool with him.

Superior Oil Co., 519 S.W.2d at 482.

In the context of the majority of states' compulsory pooling statutes, the MIPA is comparatively weak. First, the MIPA only applies to reservoirs discovered and produced after March 8, 1961. *See* Tex. Nat. Res. Code Ann. § 102.003 (West). This restriction greatly limits the number of reservoirs in Texas subject to the MIPA, because the great majority of the reservoirs in Texas were discovered and produced, at least at some level, prior to 1961. If the reservoir is one discovered and produced after March 8, 1961, then the MIPA might apply if:

- 1) at least two separately owned tracts of land are included in a common reservoir for which the Commission has established the size and shape of proration units;
- 2) the oil and gas interest owners in the reservoir have not agreed to pool their interests; and
- 3) at least one of the *owners with a right to drill* makes the proper application to the Commission.

Id. § 102.011. Before applying for compulsory pooling, an applicant must make a fair and reasonable voluntary pooling offer to the parties whose interests the applicant seeks to pool hers with. *Id.* § 102.013(b). Within an existing proration unit, an owner of a royalty or other interest in oil and gas who offers to share on the same "yardstick" basis as the other owners within a unit makes a fair and reasonable offer. *Id.* § 102.013(c). A party who does not pay her proportionate share of drilling and completion costs up front must reimburse the parties out of her share or production for her proportionate share of all actual and reasonable drilling, completion, and operating

costs plus a charge for risk no more 100% of all such costs. *Id.* § 102.052(a).

In *Carson v. R.R. Comm'n of Texas*, 669 S.W.2d 315 (Tex. 1984), the voluntary pooling offer was made after the operator had completed a producing well on the tract in which the party who owned the interest seeking to be pooled owned an interest. The voluntary pooling offer letter stated that said party was required to sign the ratification agreement to share in the proceeds of the well. In the letter, the lease covering the interests in question did not contain authorization, but it noted that it expected the Commission to grant the operator authority to pool. The party who owned the interest in question responded by suggesting that the operator compensate him for reducing his interest in the well proceeds to reflect prevailing royalties under modern leases. However, the operator refused to negotiate, stating that it did not feel obligated to do so. The court held that the operator's proposal would have reduced the royalty owner's interest in gross production by approximately two-thirds, while allowing owners of royalty interests who would not otherwise participate in production from the well to share in those proceeds. This, the court stated, was not a fair and reasonable offer and as such, the forced pooling order was improperly entered. *Id.* at 318. While the court did not define a "fair and reasonable offer," it did state that the "offer must be one which takes into consideration those relevant facts, existing at the time of the offer, which would be considered important by a reasonable person in entering into a voluntary agreement concerning oil and gas properties." *Id.*

Likewise, in *R.R. Comm'n of Texas v. Broussard*, 755 S.W.2d 951 (Tex. App. 1988—Austin, writ denied), mineral interest owners made an offer to voluntarily pool with adjoining owners. At the time of the offer, evidence showed that the producing wells on the adjoining lands were not draining the lands of the interest owners seeking to pool (although drainage could have occurred during secondary recovery efforts). The court, upholding the Commission's dismissal of the application to pool under the MIPA, held that because the adjoining lands were not draining the lands of the interest owners at the time of the offer, the offer to pool was not fair and reasonable. *Id.* at 953–54 (noting that "[t]he Commission determined that, without current drainage occurring, forced pooling would not accomplish the MIPA's objective of preventing drainage").