

TEXAS POOLING OVERVIEW

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Pooling is . . .

- basic legal tool for drilling oil and gas wells and developing oil and gas properties

Pooling is . . .

- as important today as ever:
 - Texas increasingly urban
 - wide-open rural land disappearing
 - mineral ownership divided into smaller parcels

Pooling is . . .

- particularly valuable in North Texas Barnett Shale
 - few large tracts
 - many small tracts, subdivisions, and town sites
 - fewer drill site tracts
 - many drilling restrictions
 - existing Pooled Units

Pooling is . . .

- often operator's *best* tool for
 - meeting lease deadlines
 - observing lease obligations and covenants
 - complying with regulatory requirements
 - providing for orderly development
 - avoiding unnecessary wells
 - protecting correlative rights
 - promoting conservation

Pooling is . . .

- Result of work by all oil and gas disciplines
 - Geology and Geophysics
 - Reservoir Engineering
 - Land
 - Regulatory
 - Legal

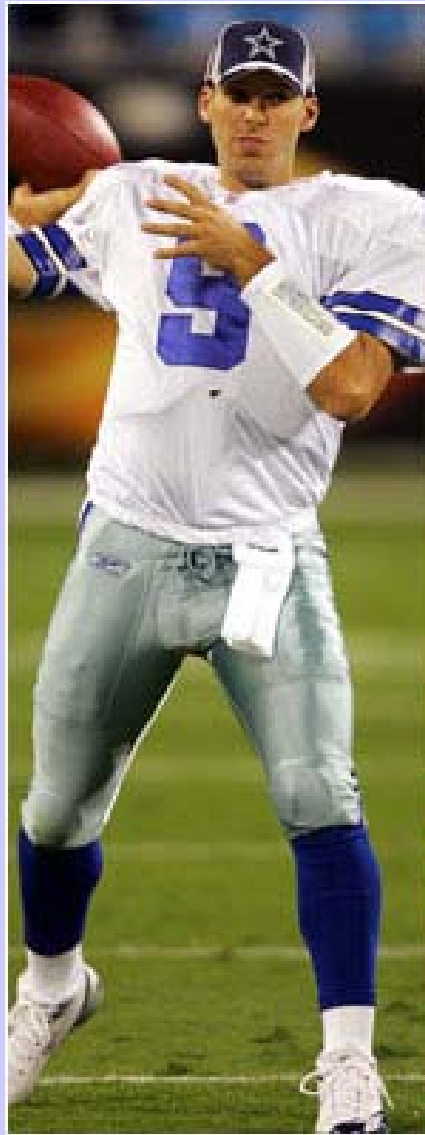
Pooling is . . .

- combination of tracts
- from two or more leases
- to drill a well

Two Separate Tracts and Leases

Tony Lease
40 Acres

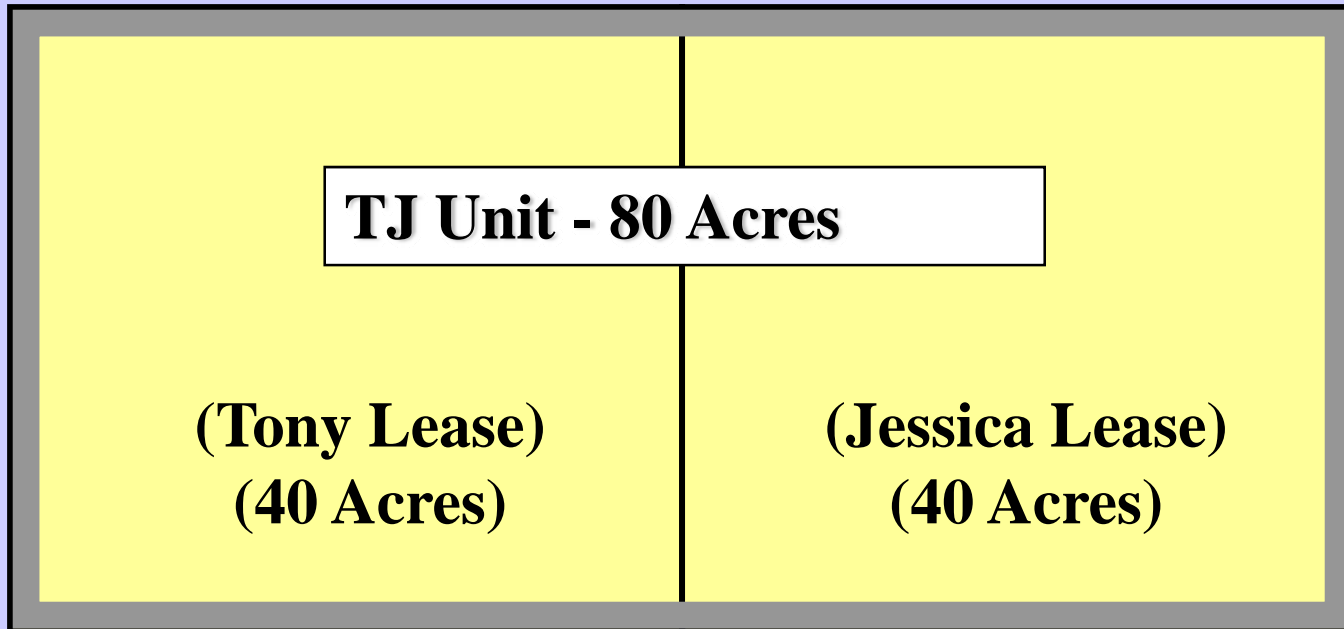
Jessica Lease
40 Acres



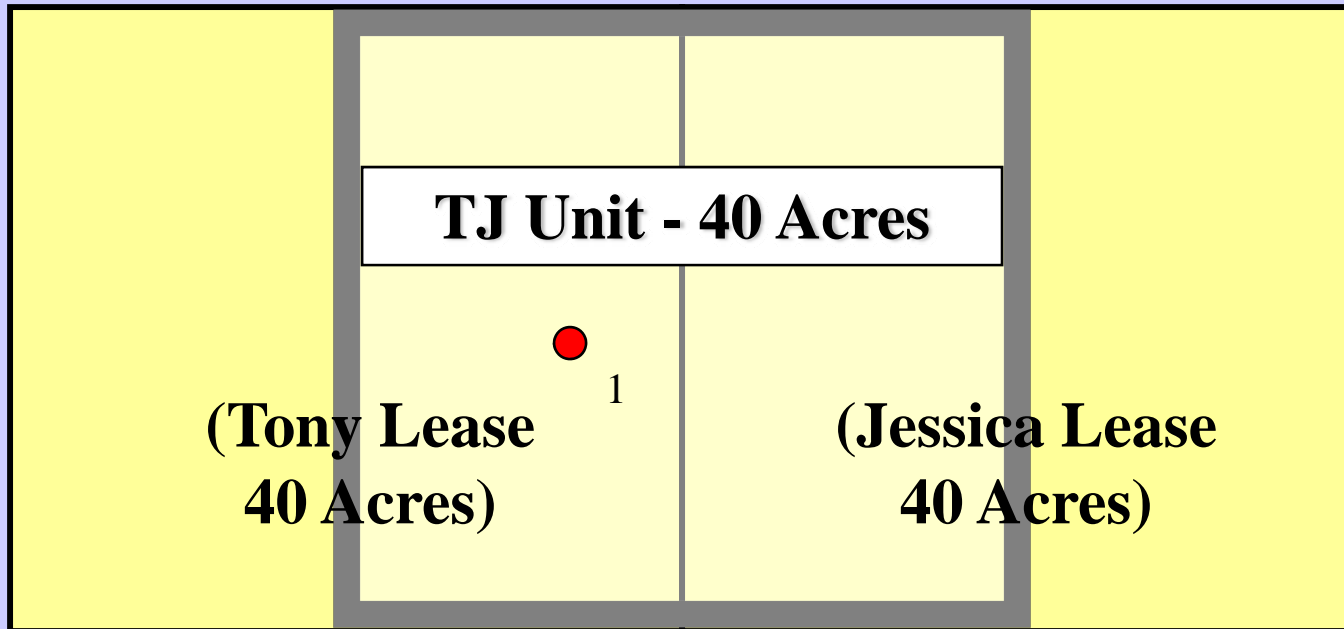
Pooling of another kind . . .



Pooled Unit (All of Two Leases)



Pooled Unit (Two Tracts from Two Leases)



Primary legal effects . . .

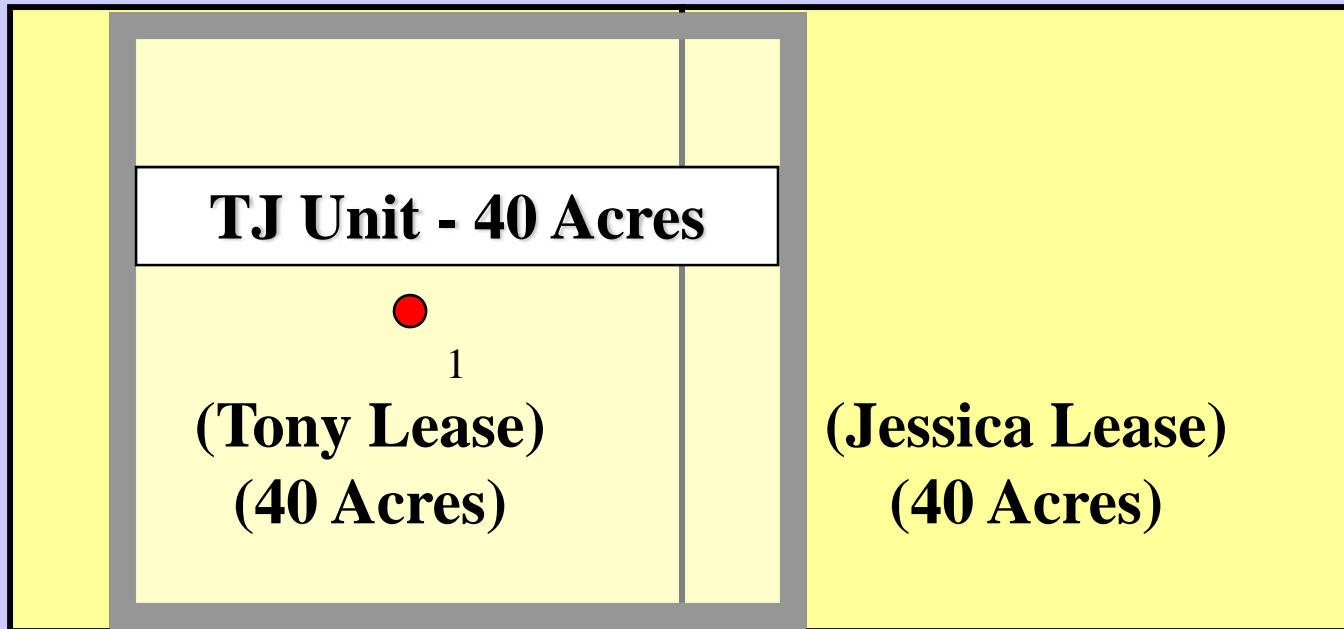
- operations anywhere as if on each tract
- production anywhere as if from each tract
- production shared, usually in proportion to acreage

Two Separate Tracts and Leases

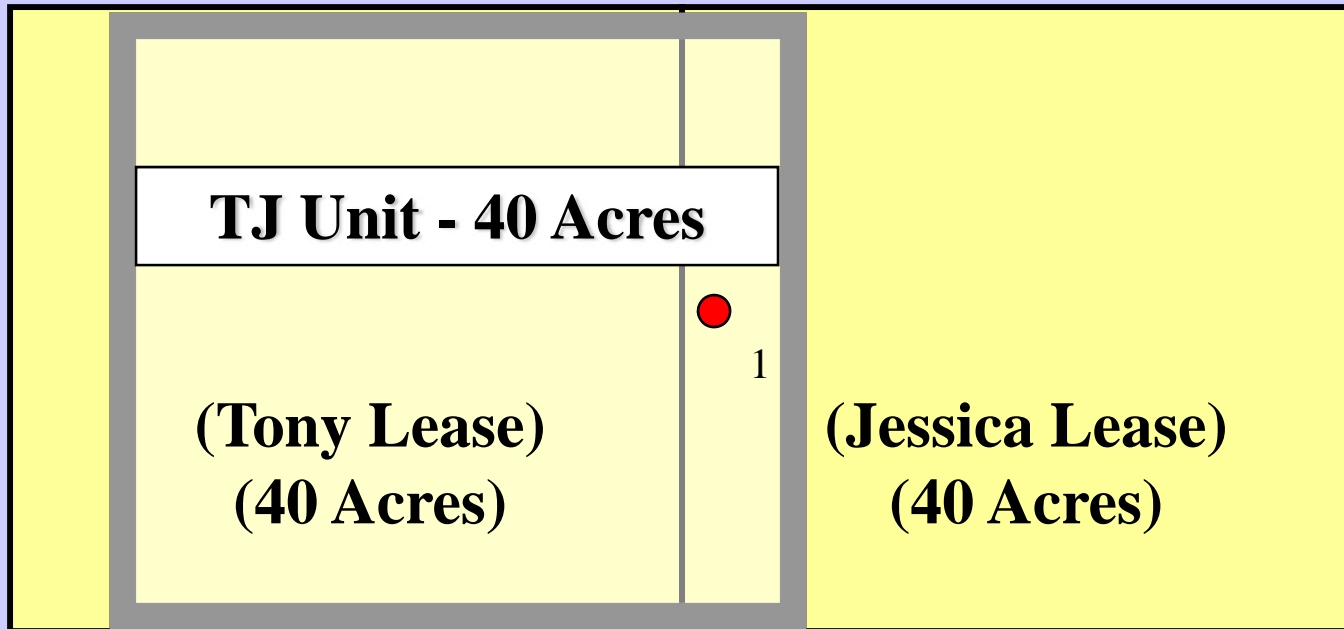
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40 Acres

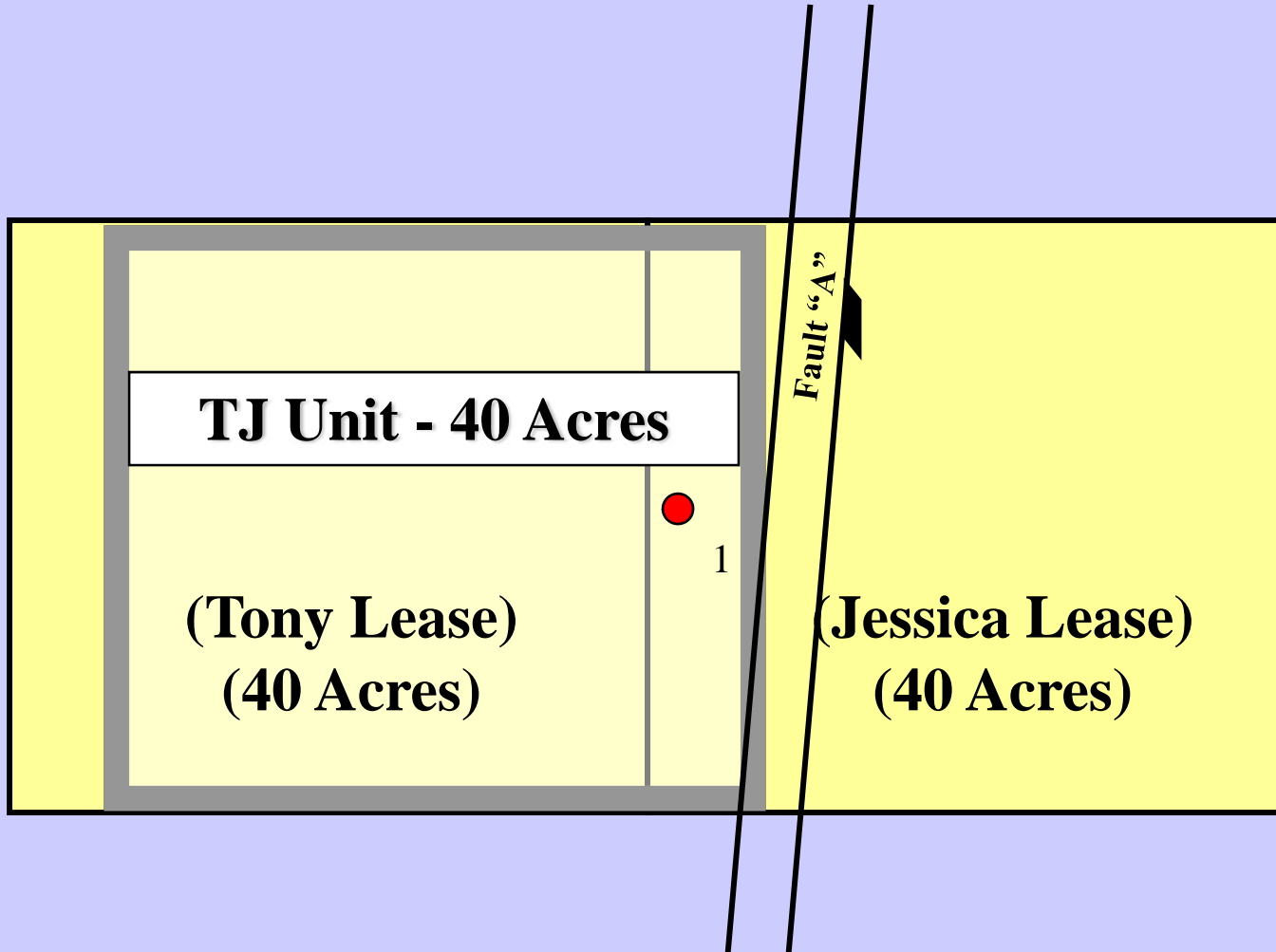
Jessica Lease
40 Acres

Pooled Unit (Two Tracts from Two Leases)



Pooled Unit (Two Tracts from Two Leases)





Two types of Pooled Units:

- Voluntary Pooled Unit
 - Most common
 - Created under authority in leases
- or -
- Created by agreement

Two types of Pooled Units:

- Forced Pooled Unit
 - Very rare
 - Created by RRC order under the MIPA
 - Tex. Nat. Res. Code Chapter 102

“Units” that are not Pooled Units:

- Drilling Unit
- Proration Unit
- Field Unit

(Caution: These often cause confusion.)

A Drilling Unit is . . .

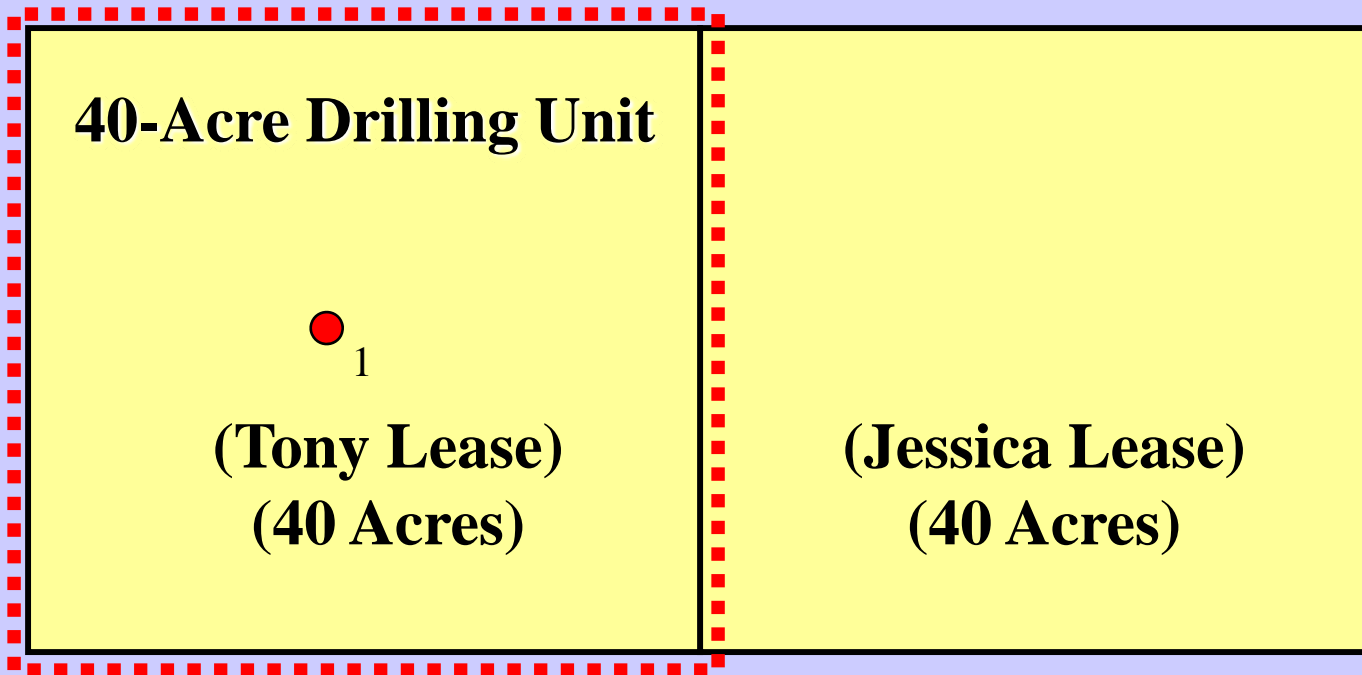
- RRC terminology
- Acreage designated when applying for permit
 - Selected by operator
 - Can be amended by operator during permitting
 - Historically required for permit
 - no longer used with electronic permitting procedures

Two Separate Tracts and Leases

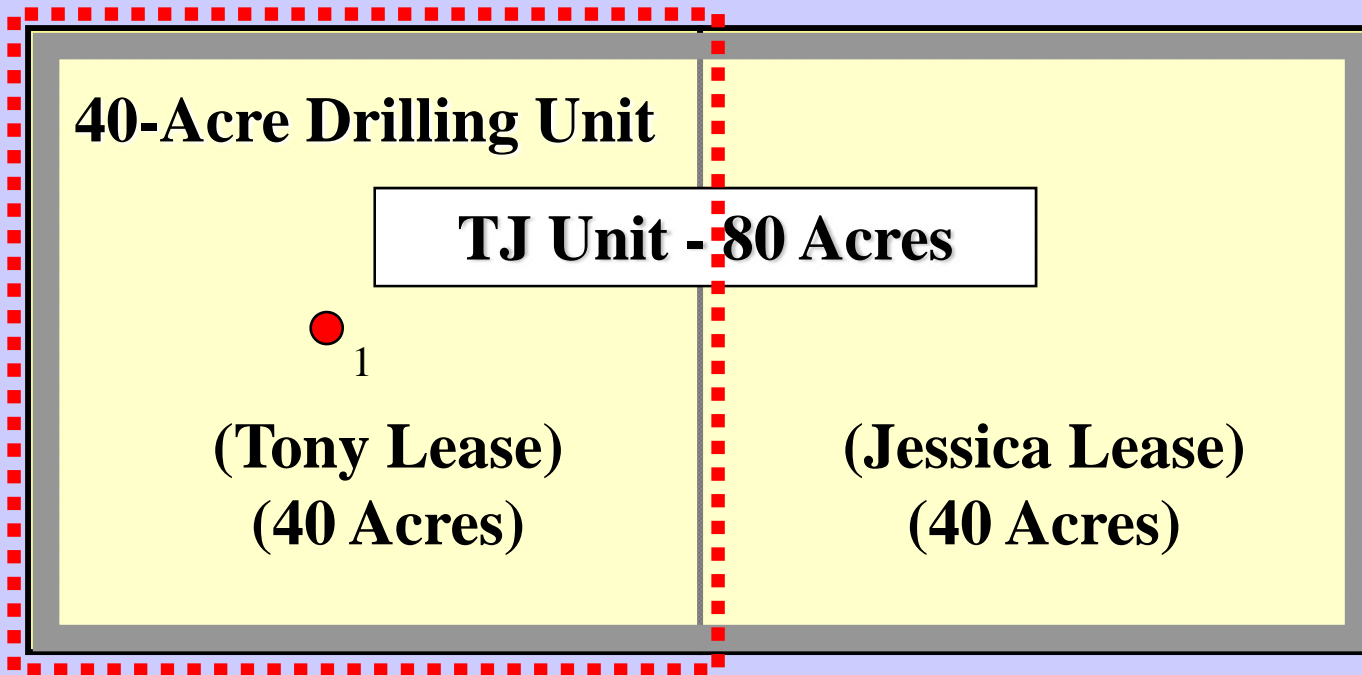
Tony Lease
40 Acres

Jessica Lease
40 Acres

DRILLING UNIT



DRILLING UNIT



A Proration Unit is . . .

- RRC terminology
- Productive acreage assigned to obtain allowable
 - Only in fields with special field rules
— and —
 - Only if field has productive acreage allocation
- Not used under RRC's Statewide Rules

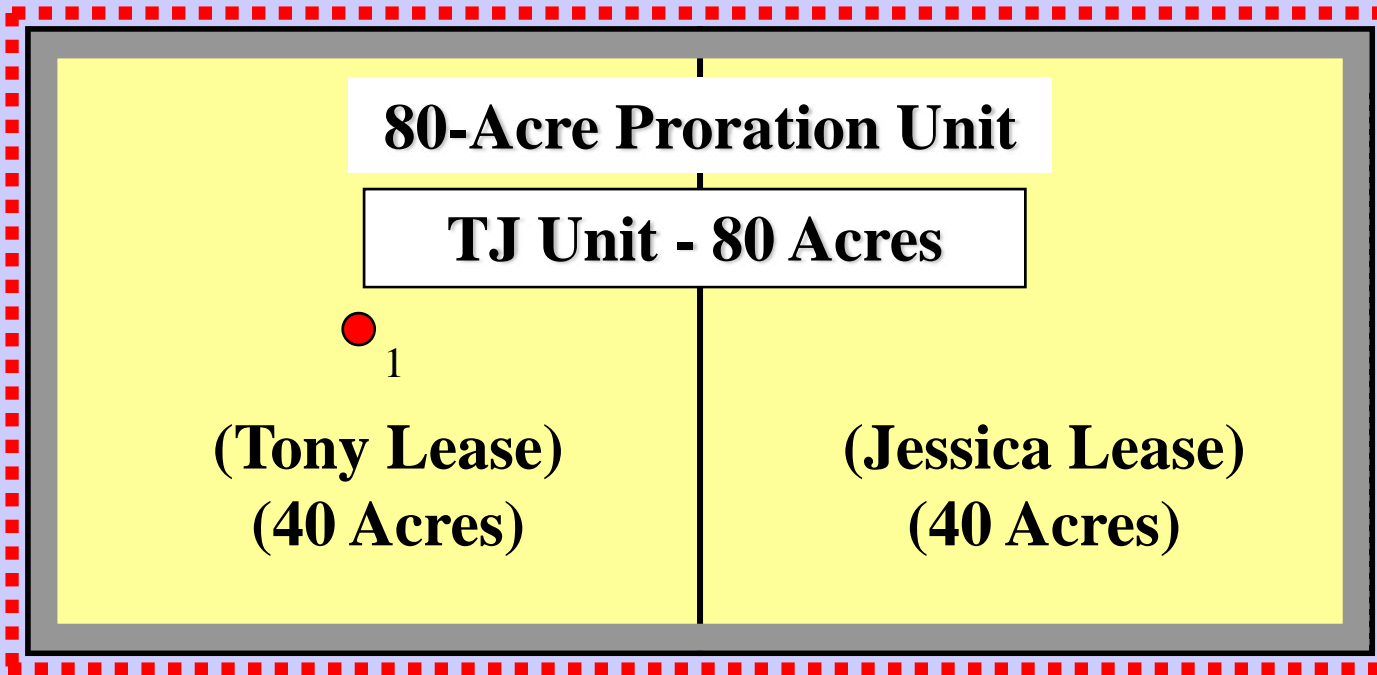
(Fewer and fewer wells have Proration Units.)

Two Separate Tracts and Leases

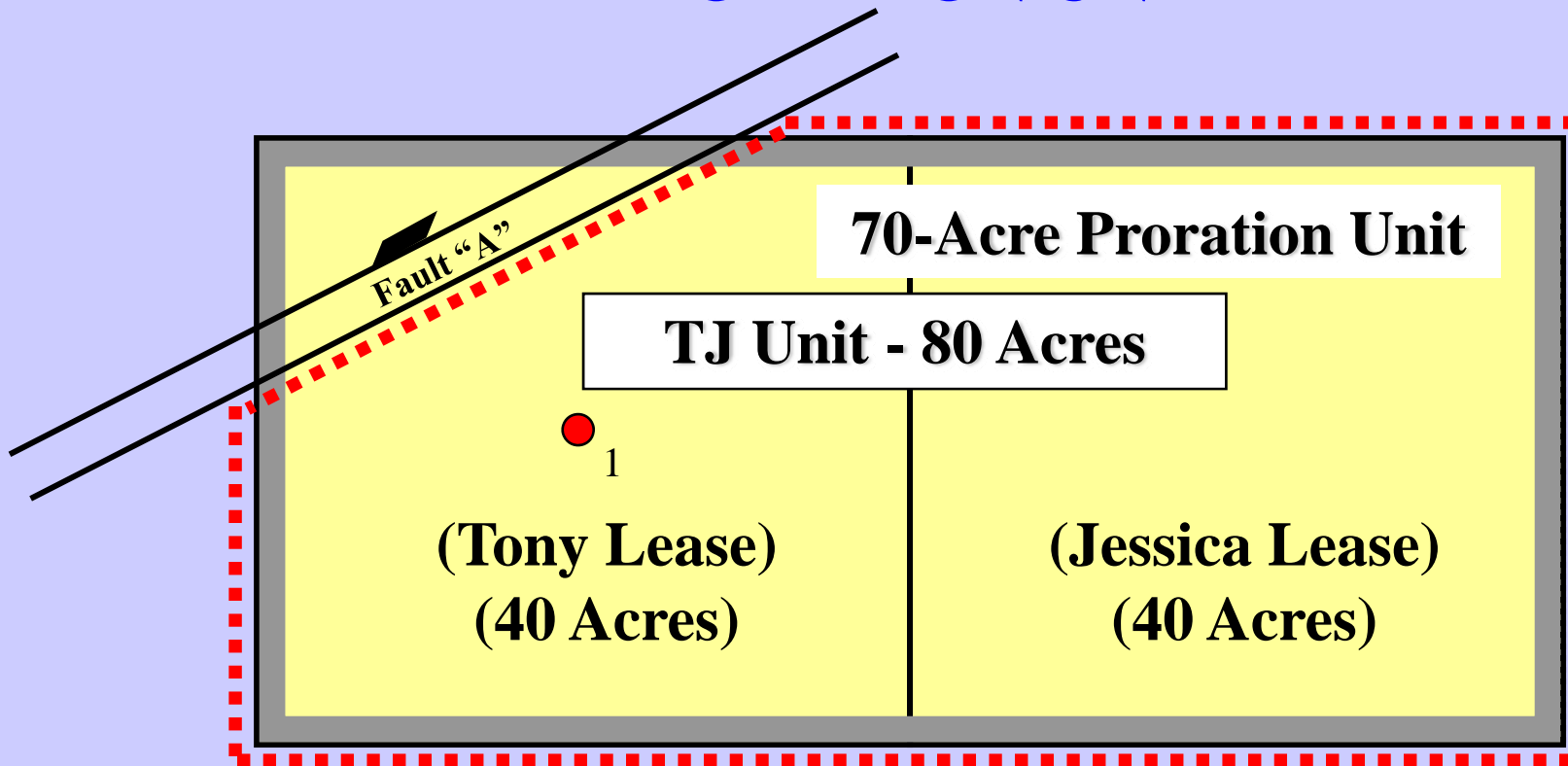
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40 Acres

Jessica Lease
40 Acres

PRORATION UNIT



PRORATION UNIT



A Field Unit is . . .

- aka
 - Fieldwide unit
 - Partial fieldwide unit
 - Secondary recovery unit
 - Waterflood unit
 - Enhanced recovery unit
- legal combination of tracts from two or more leases to conduct operations beyond primary production

A Field Unit typically involves

- all or substantial portion of a reservoir
- injection operations that intentionally move hydrocarbons across lease lines
- agreement by mineral interest owners
- approval of unit agreement by RRC

Pooling Authority:

- Authority to pool comes from the lessor.

“Absent express authority, a lessee has no power to pool interests in the estate retained by the lessor with those of other lessors.” *Jones v. Killingsworth*, 403 S.W.2d 325 (Tex. 1965).

Tittizer v. Union Gas Corp., 171 S.W.3d 857 (Tex. 2005) Court recognizes that lessee has no implied power to pool.

Pooling Authority:

- Typical language:

Lessee, at its option, is hereby given the right and power to pool or combine the acreage covered by this lease, or any portion thereof as to oil and gas, or either of them, with other land, lease or leases in the immediate vicinity thereof to the extent, hereinafter stipulated, when in Lessee's judgment it is necessary or advisable to do so in order properly to develop and operate said leased premises in compliance with the spacing rules of the Railroad Commission of Texas, or other lawful authority, or when to do so would, in the judgment of Lessee, promote the conservation of oil and gas from said premises.

Pooling Authority:

- Pooling authority granted by lease should not be construed narrowly. *Texaco, Inc. v. Lettermann*, 343 S.W.2d 726 (Tex. Civ. App.-Amarillo 1961).

Pooling Authority:

- Lessee has no power to pool absent express authority.

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

Southeastern Pipe Line Company, Inc. v. Tichacek, 997 S.W.2d 166 (Tex. 1999).

Jones v. Killingsworth, 403 S.W.2d 325 (Tex. 1965).

Tittizer v. Union Gas Corp., 171 S.W.3d 857 (Tex. 2005).

Pooling Authority:

- No Implied Duty to Pool.

Tittizer v. Union Gas Corp., 171 S.W.3d 857 (Tex. 2005).

PYR Energy Corp. v. Samson Res. Co., 456 F.Supp.2d 786, 791-793 (E.D. Tex. 2006)

Kinnear v. Scurlock Oil Co., 334 S.W.2d 521
(Tex. Civ. App.—Beaumont 1960, writ ref'd n.r.e.).

Pooling Authority:

- Nonparticipating royalty interest created before lease cannot be pooled without consent.

Brown v. Smith, 141 Tex. 425, 174 S.W.2d 43 (Tex. 1943).

- Overriding royalty interest can be pooled unless assignment limits pooling authority.

Union Pacific Resources Company v. Hutchinson, 990 S.W.2d 368 (Tex. Civ. App.—Austin 1999).

Pooling Authority:

Authorization for unit size is often 40 acres for oil and 640 acres for gas:

“Units pooled for oil hereunder shall not substantially exceed 40 acres each in area, and units pooled for gas hereunder shall not substantially exceed in area 640 acres each plus a tolerance of 10% thereof.”

(Sometimes you will see leases with pooling for oil at 80 acres or for gas at 160 or 320 acres.)

Pooling Authority:

- Leases often key pooling to RRC regulation
 - “Prescribed or permitted by governmental regulation”
 - “Regular Location”
 - “Maximum Allowable”
 - “Horizontal Lateral Length Under Rule 86”

Pooling Authority:

- Pooling more than once:
 - Many forms contain authorizing language.
 - Unless limited by the oil and gas lease, pooling authority may be exercised more than once, if the pooling is in good faith. *Texaco v. Letterman*, 343 S.W.2d 726 (Tex. Civ. App.—Amarillo 1961).

Pooling Authority:

- Enlarging an existing Pooled Unit:
 - Many lease forms contain authorizing language.
 - Where court found enlargement would benefit both lessee and lessor, enlargement approved without specific authorizing lease language. *Expando Production Company v. Marshall*, 407 S.W.2d 254 (Tex. Civ. App.—Fort Worth 1966).

Pooling Authority:

- Reducing size of existing Pooled Unit
 - In effect, terminates existing Pooled Unit and creates new one
 - Rarely authorized by lease
- Requires authority in all leases pooled, or express consent from all lessors.

See Ladd Petroleum Corporation v. Eagle Oil and Gas Company, 695 S.W.2d 99 (Tex. Civ. App.—Fort Worth 1985, no writ).

Pooling Authority:

- Effective Date of Pooling
 - Many lease forms key effective date to date pooling declaration recorded.
 - Courts enforce record-to-be-effective provisions. *See Tittizer v. Union Gas Corp.*, 171 S.W.3d 857, 860 (Tex. 2005); ; *Sauder v. Frye*, 613 S.W.2d 63 (Tex. Civ. App.—Fort Worth 1981, no writ).
 - Compare *Tiller v. Fields*, 301 S.W.2d 185 (Tex. Civ. App.—Texarkana 1957, no writ).

Pooling Authority:

- Pooling authority must be exercised in good faith.
 - Less than fiduciary duty
 - Lessee may consider own interest
- Cases:
 - *Elliott v. Davis*, 553 S.W.2d 223 (Tex. Civ. App.—Amarillo 1977)
 - *Banks v. Mecom*, 410 S.W.2d 300 (Tex. Civ. App.—Eastland 1966)
 - *Circle Dot Ranch, Inc. v. Sidwell Oil and Gas, Inc.*, 891 S.W.2d 342 (Tex. Civ. App.—Amarillo 1995)

Pooling Authority:

- Indicators of bad faith:
 - Gerrymandering
 - Pool Unit created shortly before end of primary term
 - Pooled Unit has irregular shape
 - Part of drill site lease with plenty of unpooled productive acreage pooled with non-drill site lease

Pooling Authority:

- Indicators of bad faith:
 - Geological conditions not considered
 - Pooled Unit does not match geology
 - Productive drill site acreage near well excluded
 - Non-productive non-drill site acreage included

Pooling Authority:

- Indicators of bad faith:
 - Pooled Unit includes acreage not in drainage pattern
 - No plans for additional drilling
 - Express statements

Pooling Authority:

- Recommendations for “Good Faith”
 - Match Pooled Unit to lease authority
 - Match Pooled Unit to geology
 - Match Pooled Unit to development

Pooling Authority:

- Recommendations for “Good Faith”
 - Pool only acreage that well will drain
 - Document drainage analysis
 - If pooling more acreage than first well will drain
 - document plans for additional wells
 - and-
 - recognize risk

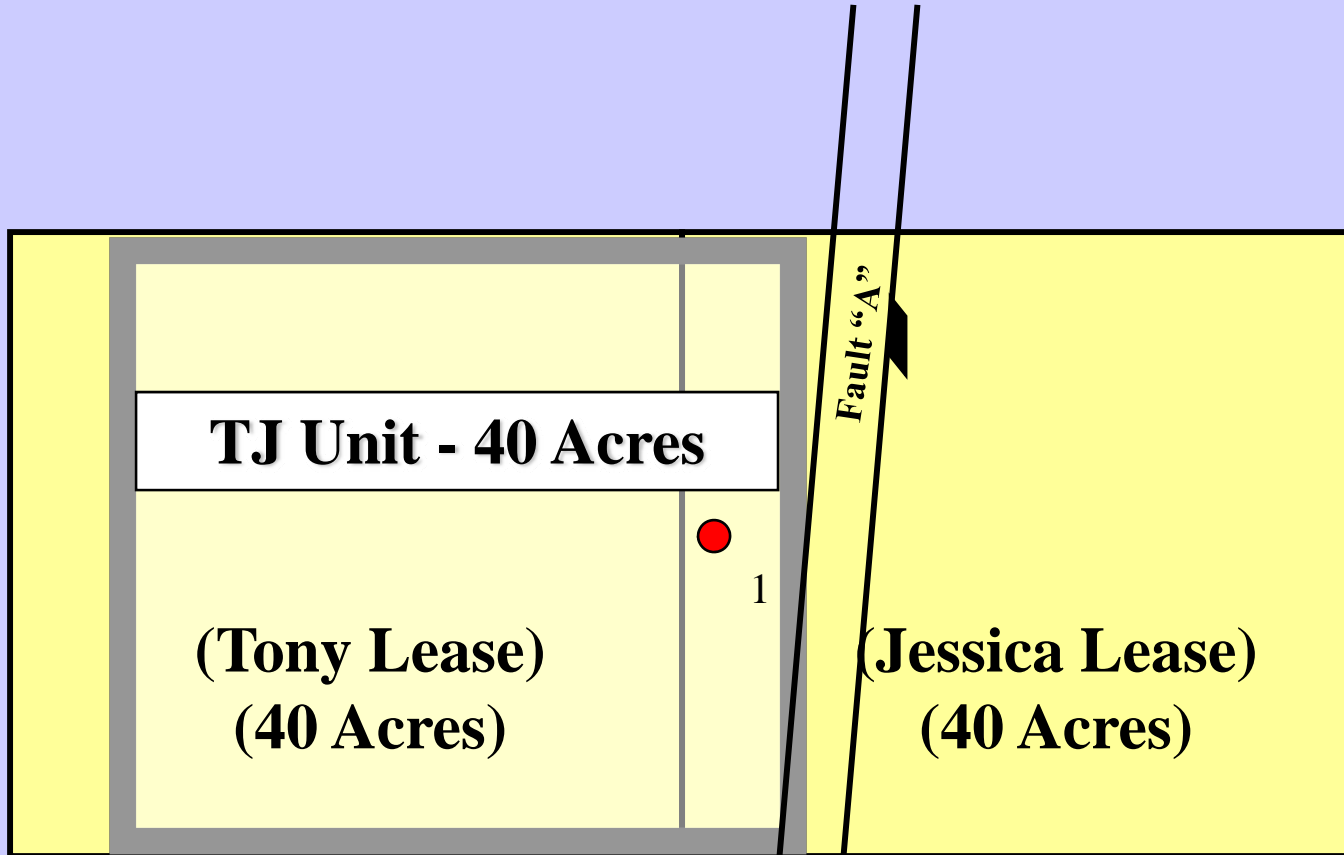
Pooling Authority:

- Recommendations for “Good Faith”
 - Avoid irregular shapes
 - Avoid last minute pooling
 - Records and maps should match pooling
 - Document and preserve changing interpretations
 - Preserve Pre-drill versus Post-drill maps
 - Avoid “Geology Disease”

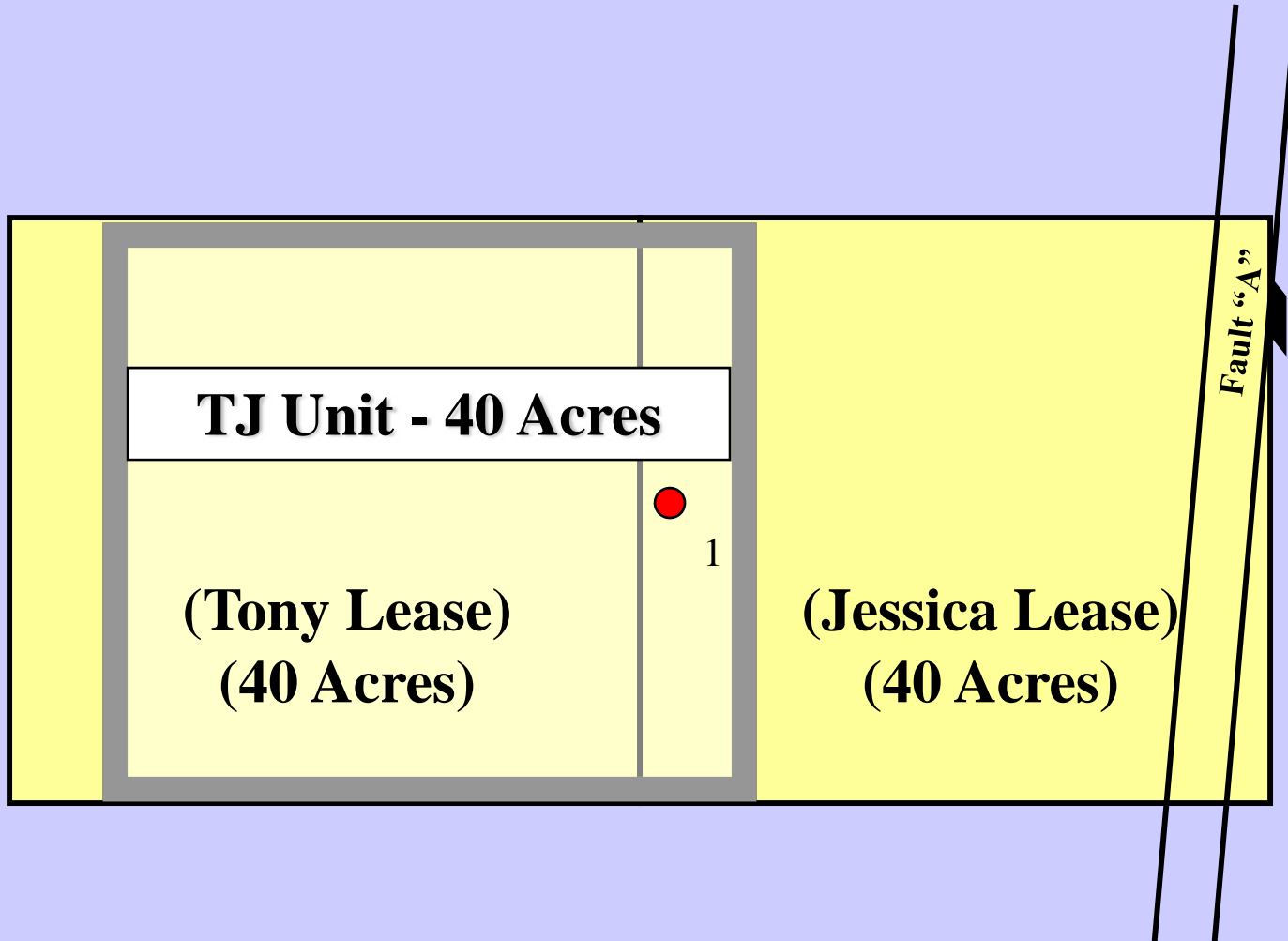
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Pre-Drill



Post-Drill

Modern Problems:

Pooling and Subprime Lending

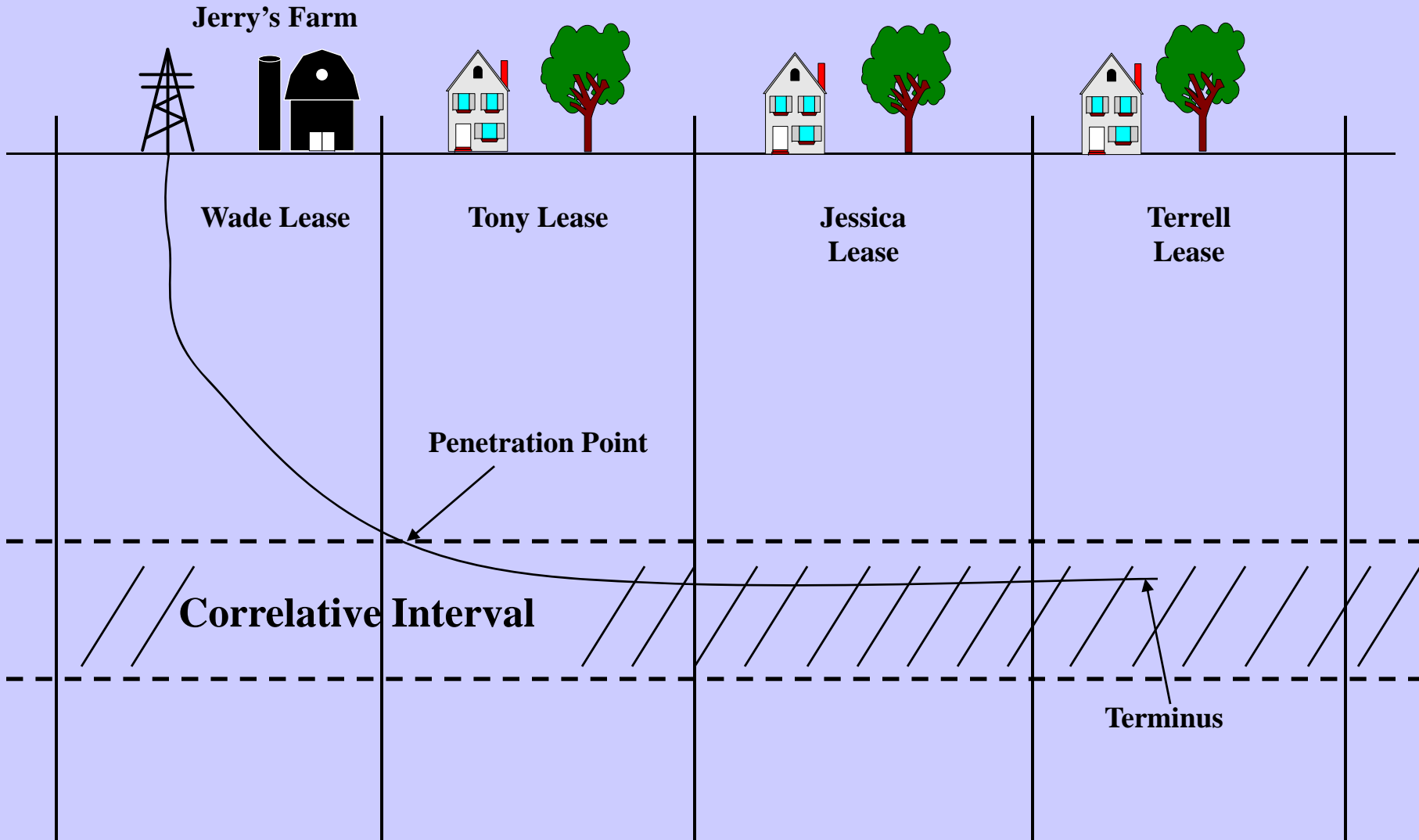
The Problem: Oil and Gas Lease taken after a Mortgage does not survive foreclosure sale.

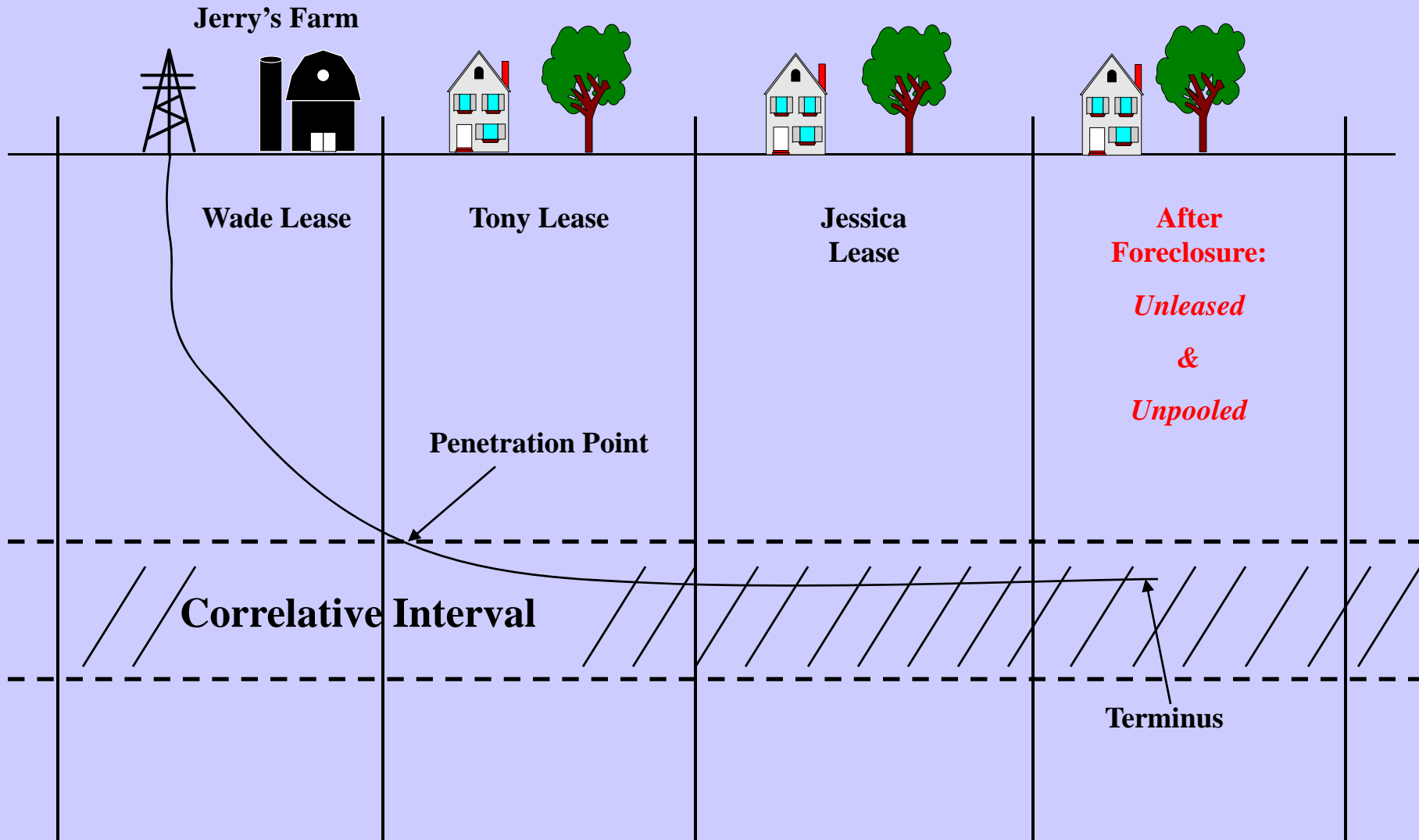
The Result: After foreclosure sale, Oil and Gas Lease terminates and tract is no longer pooled.

*Modern Problems:
Pooling and Subprime Lending*

The Potential Issues:

- Permit Validity
- Trespass
- Commingling





Modern Problems:

Pooling and Subprime Lending

Possible Solutions:

- Lender Subordination
- Re-Leasing & Re-Permitting
- Force Pooling

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