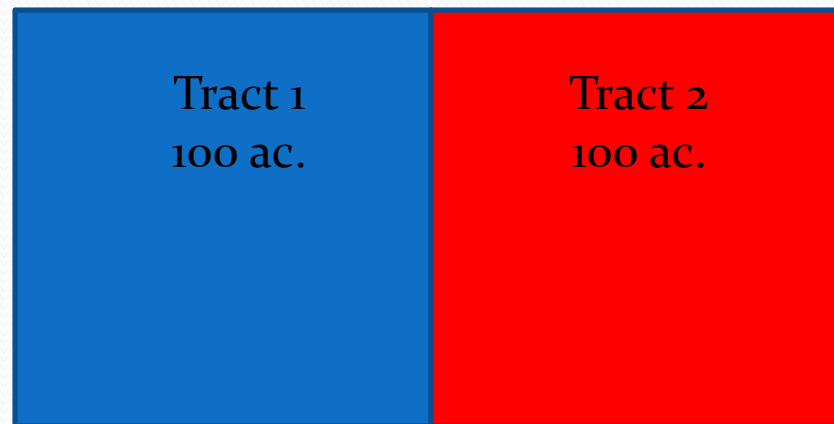


# Pooling: The Unintended Consequences

M. Ryan Kirby  
Kirby, Mathews & Walrath, PLLC

# General Pooling Concepts

- **Working Definition of Pooling**
  - The joining of tracts from two or more leases into a single drilling unit for the purpose of obtaining sufficient acreage to obtain a drilling permit.



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  - The joining of tracts from two or more leases into a single drilling unit for the purpose of obtaining sufficient acreage to obtain a drilling permit.

Pooled Unit  
200 ac.



# General Pooling Concepts

- **Purpose of Pooling**

- Combining small tracts into an area sufficient to obtain a drilling permit under field spacing or density rules.  
Texas Railroad Commission Rules 37 and 38





# General Pooling Concepts

- **Effect of Pooling**

- Cross-conveyance of interests in land by agreement among the participating parties.
- Royalties are allocated to all pooled lands on a surface acreage basis.
- Production on any of the pooled tracts treated as production on all tracts.



# General Pooling Concepts

- **Required Authority to Pool**

- “A lessee’s power to pool is derived solely from the terms of the lease; a lessee has no power to pool absent express authority.” *Browning Oil Co. v. Luecke*
  - Usually granted in pooling clause of lease.
  - If no pooling authority in lease, Lessors may pool by separate instrument or execution of Unit Designation.
  - Authority must be obtained from all interest owners, including non-executive owners (NPRI and NEMI).



# General Pooling Concepts

- **Required Authority to Pool**
  - Exception – Mineral Interest Pooling Act
    - Texas statute permitting forced pooling.
    - Very rarely utilized.





# General Pooling Concepts

- **Limitations on Authority to Pool**
  - Good Faith Standard – Lessee is not a fiduciary for Lessor.
  - What is Bad Faith Pooling?
    - Fact issue – Not a legal issue.
    - No single factor is determinative.
  - Examples of Bad Faith Pooling:
    - Including non-productive acreage in Unit
    - Ignoring geological/seismic data
    - Gerrymandering boundaries to perpetuate multiple leases





# General Pooling Concepts

- **Limitations on Authority to Pool (Cont.)**

- Pugh Clause
  - Non-drillsite tracts – only lands within Unit are held.
- Acreage limitations
  - Expressly stated in pooling provision included in lease.
- Anti-dilution provisions
  - Requires certain number or percentage of acres within a tract be included in Unit.
- Governmental Authority
  - Prescribed acreage based upon field rules or statewide rules.



# Comparison to Other “Unit” Types

- **Drilling Unit**
  - Also called Spacing Unit or Development Unit
  - The acreage assigned to a well for drilling purposes pursuant to Rule 38.
  - RRC regulation of spacing units does not change property rights, which remain governed by the common law rule of nonapportionment.



# Comparison to Other “Unit” Types

- **Proration Unit**

- The acreage assigned to a well for the purpose of determining the amount of production that will be permitted by the RRC from that particular well.
- Proration Unit does not effect a pooling of the lands covered by the proration unit.





# Comparison to Other “Unit” Types

- **Unitization**

- Secondary recovery efforts.
- The coordinated development of all or most of a particular reservoir.
- Usually requires much more to accomplish than a single pooled unit.



# Unintended Consequences of Pooling: Increasing Pooled Unit Size

- **The Law:**

- At least one Texas court has held that an existing pooled unit may be enlarged, provided the lessee exercises the pooling authority in good faith, without express approval in the pooling provision of the leases.

- *Expando Production Co. v. Marshall*



# Unintended Consequences of Pooling: Reducing Pooled Unit Size

- **Scenario:**

- Oil Co. operates Unit A, a pooled gas unit, which is currently producing from a shallow depth.
- However, Unit A is pooled to all depths.
- Oil Co. has leased acreage adjacent to the Unit A, and intends to develop that acreage, along with a portion of the acreage in Unit A, into Unit B, an oil unit producing from a deeper strata.



# Unintended Consequences of Pooling: Reducing Pooled Unit Size

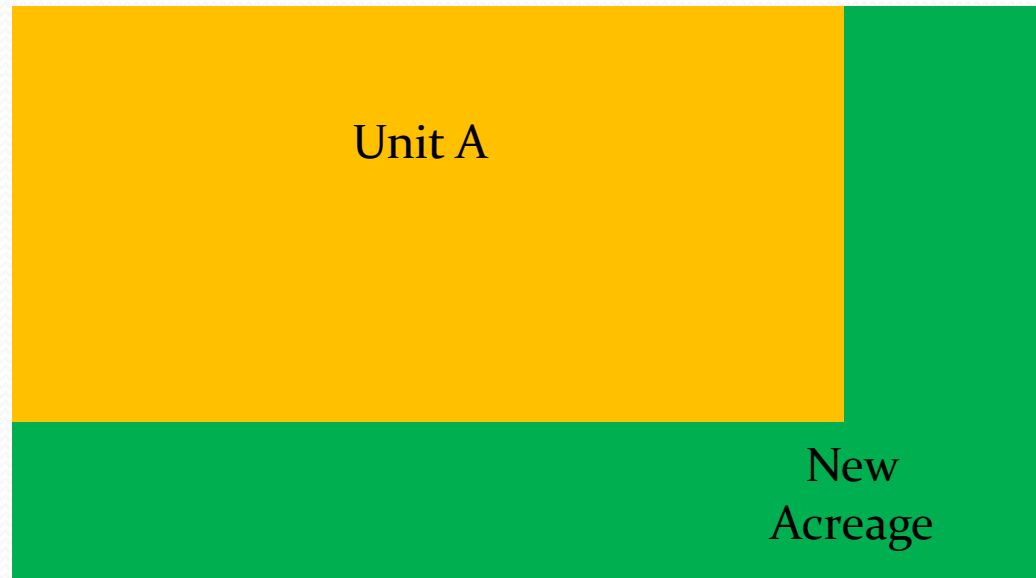
- **Scenario:**



Unit A

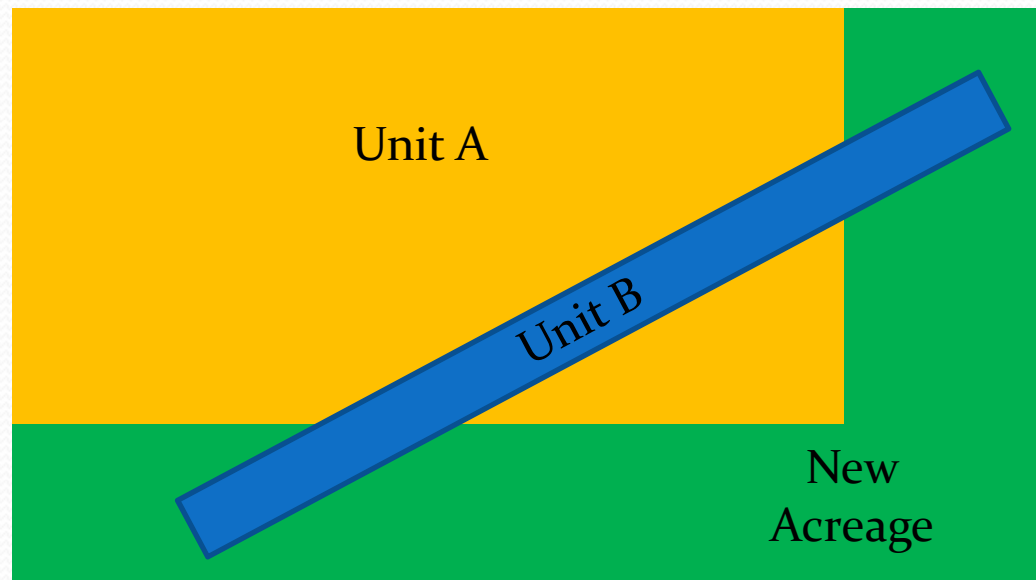
# Unintended Consequences of Pooling: Reducing Pooled Unit Size

- **Scenario:**



# Unintended Consequences of Pooling: Reducing Pooled Unit Size

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# Unintended Consequences of Pooling: Reducing Pooled Unit Size

- **The Law:**

- 1) Reductions in unit size must be authorized by:
  - The provisions of each lease within the unit, or
  - Other instrument(s) executed by all parties having executive rights within the unit.
- *Ladd Petroleum Corp. v. Eagle Oil & Gas Co.*



# Unintended Consequences of Pooling: Reducing Pooled Unit Size

- **The Law:**

- 2) Authority to reduce must be expressly stated.
- Example: *Estate of Grimes v. Dorchester Gas Prod. Co.*
  - Lease provision permitted lessee to “enlarge or change the shape of existing units” if the resulting unit was not substantially larger than allowed by prescribed government authority.
  - Holding: Authority to change shape of unit was not an express grant of authority to reduce the size of unit.



# Unintended Consequences of Pooling: Reducing Pooled Unit Size

- **Result:**
  - Unless the leases included in Unit A permit the reduction in size of a producing pooled unit, Oil Co. will be unable to develop the acreage adjacent to the Unit A, as proposed, and form Unit B.





# Unintended Consequences of Pooling: Reducing Pooled Unit Size

- **Solution:**

- Oil Co. should obtain an Amendment of Unit A and ratifications of same from all mineral, royalty, and working interest owners included in the current Unit A, said ratifications to include present words of grant of the authority to reform and reduce the size of the Unit A.

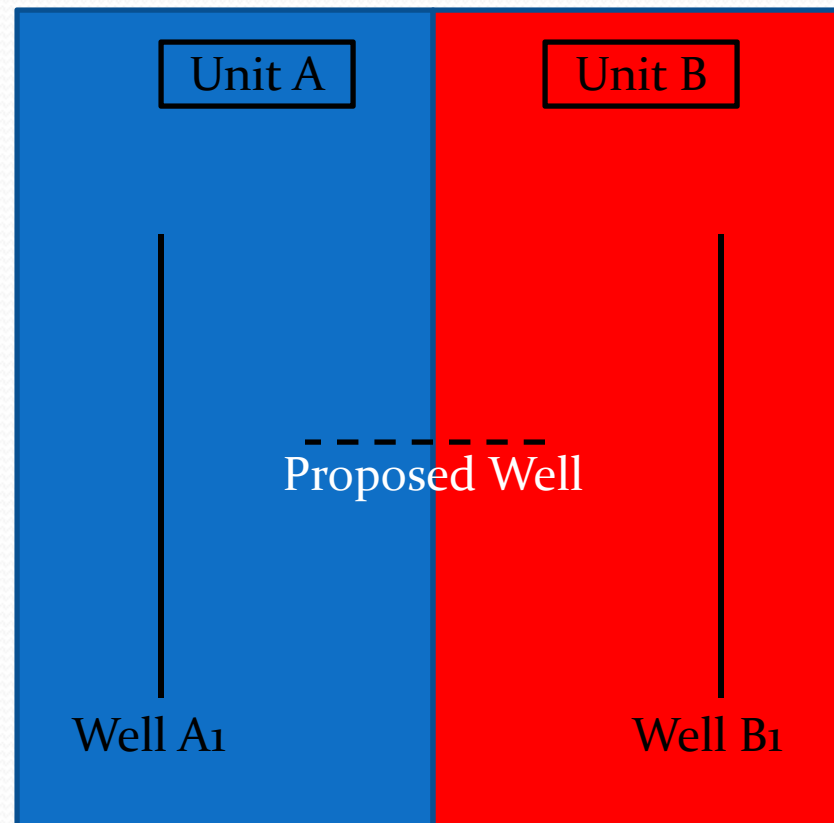


# Unintended Consequences of Pooling: The “Allocation” Well Dilemma

- **Scenario:**

- Oil Co. intends to drill a horizontal well that will traverse the boundaries of two (2) adjacent units, each of which are pooled to all depths, and each of which Oil Co. owns all working interest.
- Oil Co. does not have express pooling authority to reduce the depths of the two units in order to drill the proposed well in a new formation, and is contemplating whether to apply for either a PSA well or an “allocation” well.

# Unintended Consequences of Pooling: The “Allocation” Well Dilemma








# Unintended Consequences of Pooling: The “Allocation” Well Dilemma

- **The Regulation:**

- Production Sharing Agreement (PSA) Well
  - Working Definition: A well permitted by the RRC based upon a contractual agreement between the lessors and lessees, which specifies the manner in which production and royalties will be allocated, and is executed by at least 65% of all mineral and working interest owners in each lease, tract, or unit.
  - Purpose: Bypass need for express pooling authority.



# Unintended Consequences of Pooling: The “Allocation” Well Dilemma

- **PSA Wells**

- Pros

- No need for express pooling authority.
    - Potentially allows development on tracts that are already pooled, and would otherwise not allow for a horizontal well.



# Unintended Consequences of Pooling: The “Allocation” Well Dilemma

- **PSA Wells**

- Cons

- Production only holds drill-site tracts.
    - Royalties calculated on a well-by-well basis.
      - Compare with pooling – royalties allocated in same fashion for any well included in the pooled unit.
    - Potential liability to any interest owners that do not execute the Production Sharing Agreement.





# Unintended Consequences of Pooling: The “Allocation” Well Dilemma

- **The Regulation:**

- “Allocation” Well

- No legal or statutory definition of “allocation” well.
    - Working definition: A horizontal well drilled across two (2) or more tracts or units that have not been pooled and for which no agreement exists among the royalty owners as to how production will be shared.
    - Granted by the RRC following an operator’s assertion that the operator has a good faith claim to drill the well.
    - The practice is not formalized by any rule or regulation.




# Unintended Consequences of Pooling: The “Allocation” Well Dilemma

- **Result: In Limbo – EOG’s Klotzman Well**

- Background:

- EOG applied for an “allocation” well which would traverse two tracts – the tracts were separately owned and leased.
    - The leases covering the two tracts prohibited pooling with any other tracts.



# Unintended Consequences of Pooling: The “Allocation” Well Dilemma

- **Result: In Limbo – EOG’s Klotzman Well**
  - EOG’s Argument:
    - Drilling a horizontal well across lease boundaries is not a *per se* pooling of the tracts included, and even if it was, the authority to make such a determination does not rest with the RRC.
  - Land Owner’s Argument:
    - Production from each tract within an allocation well, prior to commingling within the wellbore, cannot be measured, giving rise to the possibility that allocated production will not be based on the amount *actually* produced from each tract; a result similar to pooling.






# Unintended Consequences of Pooling: The “Allocation” Well Dilemma

- **Result: In Limbo – EOG’s Klotzman Well**

- After a hearing, the RRC examiners denied EOG’s “allocation” well permit on the grounds that EOG did not have a good faith claim to pool acreage under any permitting scheme.
- Appears the RRC examiners determined EOG was attempting to circumvent its general lack of pooling authority.



# Unintended Consequences of Pooling: The “Allocation” Well Dilemma

- **Result: The Surprise Ending**

- The Commission, after reviewing the Examiners' report and proposal for decision (denying EOG's application), entered a Final Order on September 24, 2013, with the following conclusion of law:
- “EOG Resources, Inc. has a sufficient good faith claim to drill its proposed Klotzman (Allocation) Well” composed of the two (2) tracts at issue.



# Unintended Consequences of Pooling: The “Allocation” Well Dilemma

- **Result: The Surprise Ending**
  - Unclear if the landowners of the Klotzman Well will file suit in Texas court or allow the Commission's Final Order to be the last word on the issue of “allocation” wells for the time being.





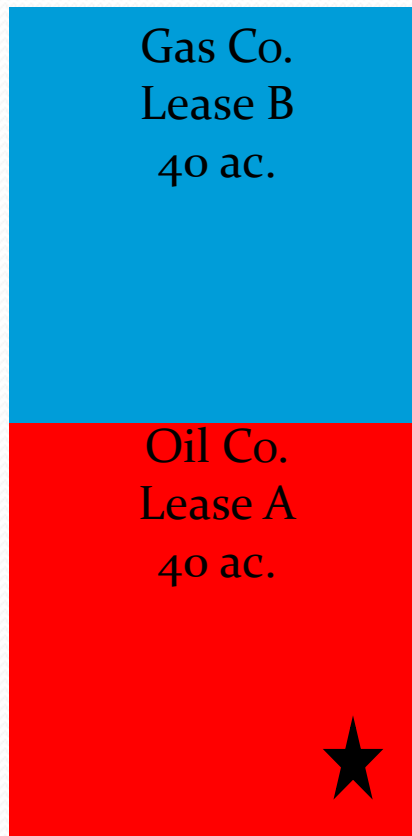
# Unintended Consequences of Pooling: The Proration Unit Dilemma

- **Scenario:**

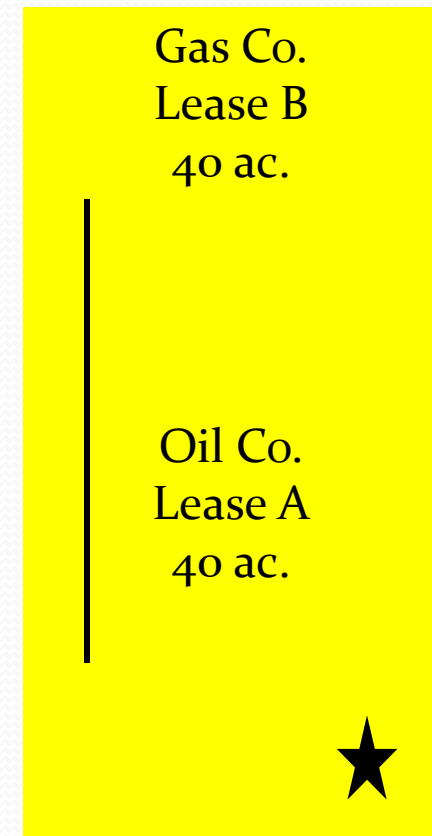
- Oil Co. owns the working interest in Lease A, a 40 acre tract, which contains the Oil Co. "A1" Well, a vertical well in a 40 proration unit.
- Gas Co. owns the working interest in Lease B, a 40 acre tract located adjacent to Lease A, with no producing wells.
- Oil Co. and Gas Co. want to execute a JOA and drill a horizontal well traversing the tracts covered by Lease A and Lease B.

# Unintended Consequences of Pooling: The Proration Unit Dilemma

- **Scenario:**



Current



Proposed



# Unintended Consequences of Pooling: The Proration Unit Dilemma

- **The Law:**

- RRC Rule 40(d)
  - Acreage assigned to a well for drilling and development, or for allocation of allowable, shall not be assigned to any other well or wells projected to or completed in the same reservoir.





# Unintended Consequences of Pooling: The Proration Unit Dilemma

- **The Law:**

- Recent Attempts to Amend RRC Rule 40(d)
  - Pioneer Natural Resources USA, Inc. recently requested the Texas Railroad Commission to amend the field rules for the Spraberry Field to permit duplicate assignment of acreage when the mineral rights in a tract are horizontally severed.
  - The RRC Examiners denied Pioneer's request.



# Unintended Consequences of Pooling: The Proration Unit Dilemma

- **The Initial Result:**

- In explaining their denial of Pioneer's request, the RRC Examiners stated that by its application, "Pioneer seeks to make the Spraberry (Trend Area) Field the only field in the State where the number of wells for a given tract is determined not by the number of productive acres in the tract and the producing characteristics of the field, but by whether the lessor and lessees have decided to contractually depth-sever the minerals."



# Unintended Consequences of Pooling: The Proration Unit Dilemma

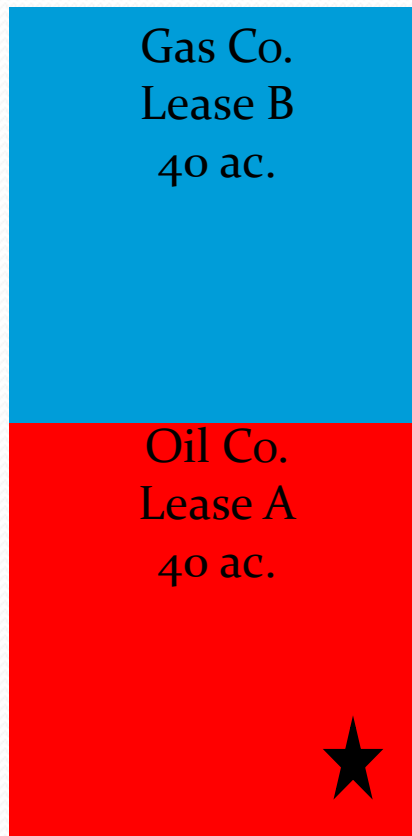
- **The Surprise Ending:**

- The Commission, after reviewing the Examiners' report and proposal for decision (denying Pioneer's request), entered a Final Order on December 18, 2013, with the following conclusion of law:
  - "Pioneer's application to amend the field rules in the Spraberry (Trend Area) Field will prevent confiscation, protect correlative rights, and will allow tracts with severed mineral rights to be developed."

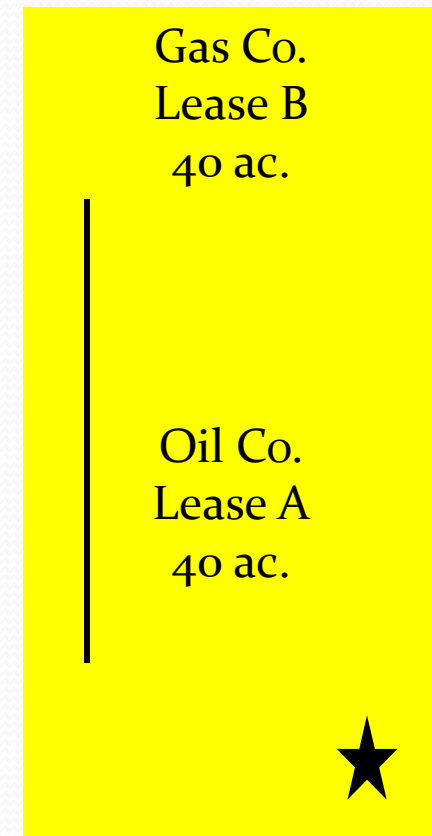


# Unintended Consequences of Pooling: The Proration Unit Dilemma

- **Scenario:**



Current



Proposed



# Questions