

1

TEXAS VOLUNTARY POOLING

2

The Legacy of the Rule of Capture

3

1862 The Phillips and Woodford Wells Titusville, Pa



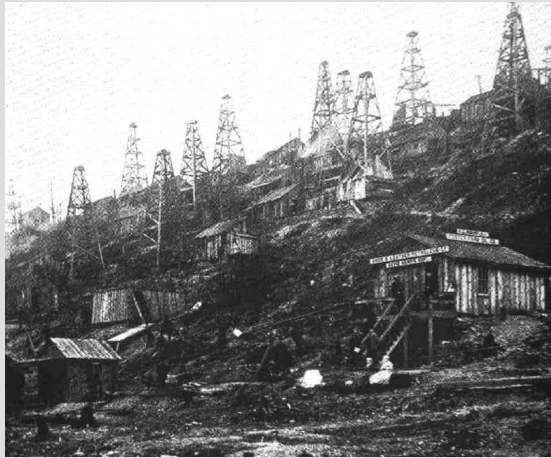
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An Early (1860's) "postcard" of Titusville area



5

1860's Bank of Oil Creek



6

Huntington Beach, CA (1890's?)



7

1903 Spindletop's Boiler Avenue



8

What is the Railroad Commission?

- Established in 1891.
- Constitutionally and Legislatively created to Regulate Rails.
- Currently, Regulates the Oil and Gas Industry.
- One of the largest and oldest agencies in the State of Texas.
- Creates Rules, Enforces Rules, and Adjudicates Rules.



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Your Most Important Resource

<http://www.rrc.state.tx.us/>

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Increasing Jurisdiction

- 1891 – Private Railroads
- 1919 – Oil and Gas
- 1920 – Gas Utilities
- 1931 – Buses and Trucks
- 1939 – LPG
- 1976 – Surface Mining
- 1991 – Alternative Fuels

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Divisions of the Railroad Commission

- Surface Mining
- Safety
- Gas Services
- General Counsel
- Oil and Gas

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The Railroad Commission does not have jurisdiction over roads, traffic, noise, odors, leases, pipeline easements or royalty payments

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“...it is well established that the commission does not have jurisdiction to decide disputes over title or rights of possession...Rather, the commission’s authority to grant permits is negative in nature – the commission, through a permit, merely removes a barrier the conservations laws would otherwise impose...” Rosenthal v. Railroad Commission of Texas, et al, 3rd Court of Appeals-Austin, Opinion ID 18426

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WELL SPACING (Rule 37)

- Lease Line Spacing
- Between Well Spacing
- 16 TAC § 3.37

WELL DENSITY (Rule 38)

- Number of acres required to obtain a regular well permit
- 16 TAC § 3.38

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-Unit-

- UNIT – A commonly misused word in our business – especially in Texas. (Generally – 16 TAC § 3.38 (Rule 38))

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Types of Units

- Drilling Unit
- Pooled Unit
- Proration Unit
- Standard Unit
- Producing Unit
- MIPA Unit
- Unitization

- The acreage assigned to a well for drilling purposes
 - 16 TAC § 3.38(a)(2)

Permit Applicant Name: _____ Address: _____ Phone Number: _____ Rate (100) Location: _____ 1) Street Number: _____		RAILROAD COMMISSION OF TEXAS OIL AND GAS DIVISION		FORM W-1 <small>WELL PLUGGING REPORT</small> DATE: _____ TIME: _____ BY: _____	
APPLICATION FOR PERMIT TO DRILL, RECOMPLETE OR RE-ENTER					
2) Operator Name (as listed on 401 permit application): _____		3) Operator License Number (as listed on 401 permit application): _____			
2) WELL INFO					
GENERAL INFORMATION					
4) Purpose of this (check ALL appropriate boxes):		<input type="checkbox"/> New well <input type="checkbox"/> Re-completion <input type="checkbox"/> Redrill <input type="checkbox"/> Fresh Drilling <input type="checkbox"/> Re-enter			
5) Direction of flow (check ALL appropriate boxes):		<input type="checkbox"/> Vertical <input type="checkbox"/> Horizontal (specify flow direction) _____			
6) Well Identification:		<input type="checkbox"/> 25 or less feet in height (see definition) <input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> 15 or less feet in depth (see definition) (see definition) (see definition)			
7) Direction of flow (check ALL appropriate boxes):		<input type="checkbox"/> Vertical <input type="checkbox"/> Horizontal (specify flow direction) _____			
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- A combination of tracts allowed by a lease pooling clause in order to combine sufficient acreage to drill a well.
 - 16 TAC § 3.40

[illegible]

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Proration unit

- BUT – 16 TAC § 3.31(c)(1)
 - If an allocation formula with acreage has not been adopted for a field, THERE ARE NO PRORATION UNITS.

See: Davin McGinnis & H. Phillip Whitworth

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Standard Units

- The well spacing and drilling unit acreage required to drill a well - Statewide Rules
 - 16 TAC §3.38(b)(2)(a)

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Production Units/Producing Units

- Not DEFINED
- Do Not Use

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MIPA Unit - Forced Pooling

- TNRC Chapter 102
- The Ammonite/GLO Problem

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Unitization

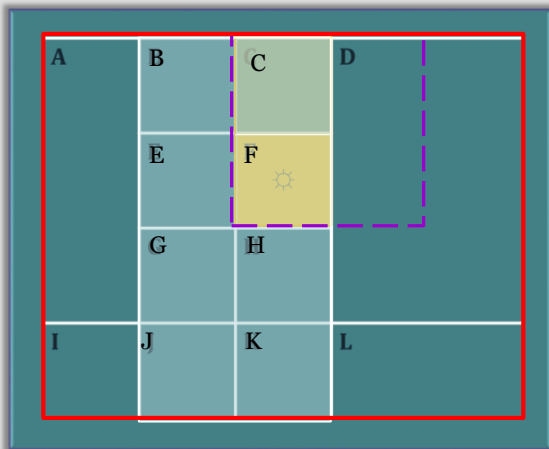
- The combination of many tracts with producing wells for the purpose of secondary or tertiary recovery.
- TNRC Chapter 101

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TYPES OF UNITS

- Voluntary Pooled Units
- Force Pooled Units
- Drilling Units
- Proration Units
- Fieldwide/Enhanced Recovery Units
- Specially Defined Units in the Lease Instruments

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Each separately labeled tract = separate lease

Tract F = 40 acre drilling unit

Tracts C and F = 80 acre proration unit

Tracts B, C, E, F, G, H, J, K = 320 acre voluntary pooled unit

Tracts C, F, 80 acre portion of Tract D = 160 acre force pooled unit

All Tracts (A-L) = fieldwide/enhanced recovery unit

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VOLUNTARY POOLING

- Why Pool?
 - Avoid drilling unnecessary wells
 - Protect each owner's correlative rights to share in production
 - Comply with RRC spacing and density regulations and obtain increased allowable
 - Obtain the best geological location
 - Maintain leases for future drilling

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Authority to Pool

- Pooling authority must be granted in the lease or by separate contract.
- Texas courts are liberal in recognizing conveyance of pooling authority and in concluding such pooling clauses should not be construed in a narrow or limited manner.
- Always start with the lease.

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REMEMBER FUNDAMENTAL DISTINCTION

- RRC rules (for spacing, density, allocation) do not create pooling authority.
- But RRC rules can impact pooling authority
 - “governmental authority” clauses – may pool to larger size if necessary for regular permit or full allowable

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O&G Lease Pooling Provisions

- Many different pooling provisions even in “standard” form leases
- Events necessary to trigger pooling authority; e.g.
 - for conservation
 - avoid unnecessary drilling
 - proper development
- **Don’t assume:** read your lease pooling provision and all riders carefully!

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Non-Contiguous Lands in Pooled Units

- No requirement that pooled units consist of contiguous lands in the absence of express lease provisions to contrary
- Special authority from the RRC is required to assign non-contiguous lands to a well for drilling permit or proration/allowable purposes
- Window pane tracts

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Effect of Changes From Gas to Oil Classification

- If no provision in lease, classification change will trigger dissolution of a gas unit.
- No second chance if lessee forms a gas unit but completes an oil well

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Unpooled Undivided Interests Within Pooled Unit Boundaries

- No equitable pooling in Texas
- Cost-bearing interests
 - Unpooled interests in a drillsite tract share as cotenants
 - A cotenant may pool his undivided interest in a non-drillsite tract without the consent of the other cotenants
 - Ratification of pooled units by non-drillsite cost-bearing interests

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- Non-participating royalty interests (NPRI's)
 - “Heads,” I win; “Tails,” you lose.
 - NPRI refuses to ratify lease if well located on NPRI's lease that pooled with other lands/leases.
 - NPRI ratifies pooled unit of well located outside of NPRI's tract.

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THE COMMON LAW

A

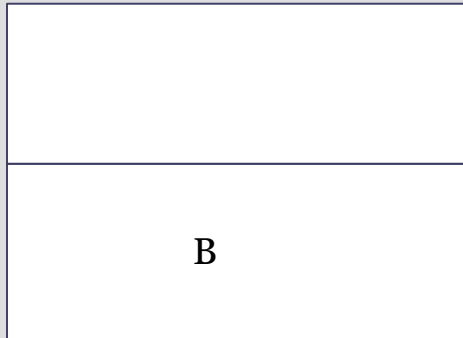


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37

THE COMMON LAW

A



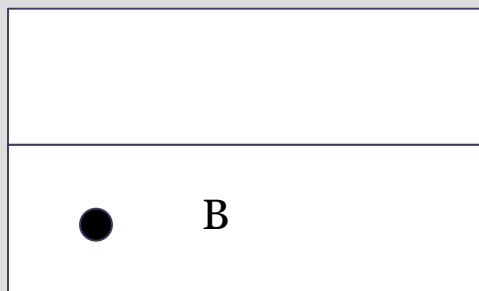
B

37

38

THE COMMON LAW

A



B

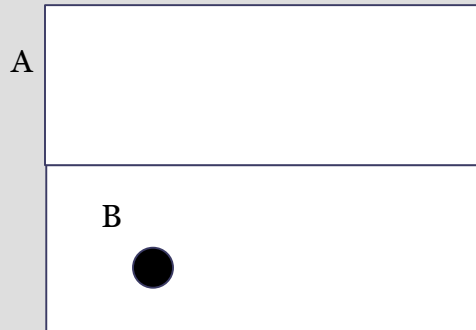
Pay royalty to A and B or B?

38

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THE COMMON LAW

Non-Appportionment



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THE COMMON LAW

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

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THE COMMON LAW

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-apportionment result can be defeated by an express contract.

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THE COMMON LAW

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 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.

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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.

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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.

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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*

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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

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.

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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.

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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*.

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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

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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*.

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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. Non-drillsite tract – can be ignored after well completed. *Fletcher v. Ricks Exploration.*
 3. No duty to offer unleased mineral owner right to participate in a pooled unit. *Donnan v. Atlantic Richfield.*

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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.*

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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.

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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 $2/64$

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CALCULATING ROYALTY WHERE NPRI IN DRILLSITE

Lease – $3/16$ R

NPRI of $1/16$ of the R
in drillsite

.	

No Ratification

MO – $3/16 \times 1/4$ (TF) = $3/64$
 NPRI – $1/16 \times 3/16$ = $3/256$
 R paid to MO – $3/64$ (-) $9/256$
 $12/256$ ($3/64$)

Ratification

MO – $3/16$ of $1/4$ (TF) = $3/64$
 NPRI – $1/16$ of $3/64$ = $3/1024$
 R paid to MO – $15/16$ of $3/64$ = $45/1024$
 $48/1024$ ($3/64$)

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Horizontal Drilling

- Railroad Commission Rules

Statewide Rules
 Or
 Special Field Rules

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WELL SPACING (Rule 37)

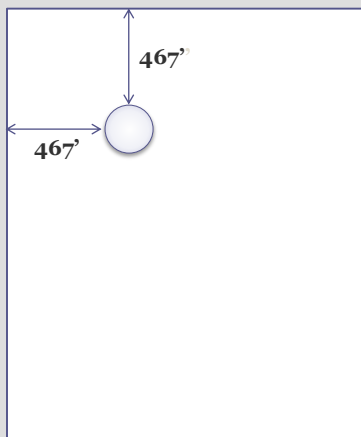
- Lease Line Spacing
- Between Well Spacing

WELL DENSITY (Rule 38)

- Number of acres required to obtain a regular well permit

62

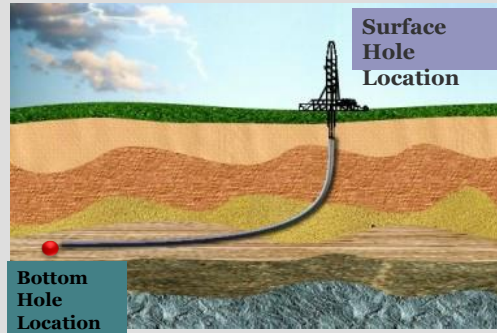
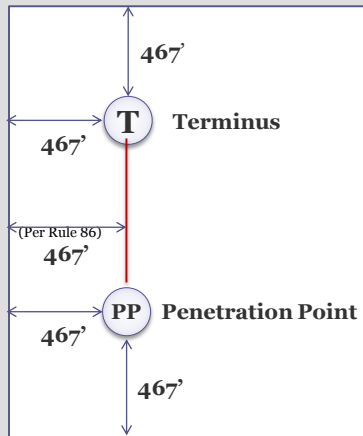
LEASE LINE SPACING



- 467' = Statewide Spacing Rule
- 330' = Typical Shale Rule
 - Barnett Shale
 - Eagle Ford
 - Haynesville

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LEASE SPACING (PER RULE 86)

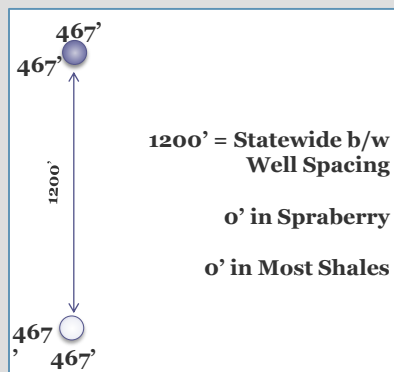


Horizontal Well

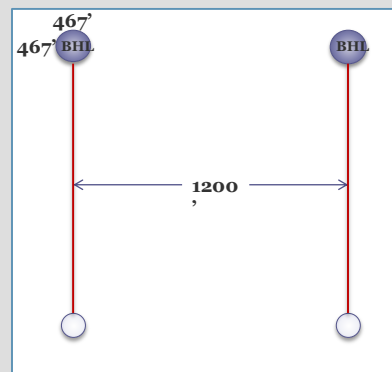
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BETWEEN WELL SPACING

Vertical



Horizontal



-Warning-

- Rule 37(e)
 - “No well drilled in violation of this section without special permit obtained, issued, or granted in the manner prescribed in said section, and no well drilled under such special permit or on the commission's own order which does not conform in all respects to the terms of such permit shall be permitted to produce either oil, gas, or geothermal resources and any such well so drilled in violation of said section or on the commission's own order **shall be plugged.** “

1. Rule 86 (16 TEX. ADMIN. CODE § 3.86)

Additional Acreage Assignment for Fields with a Density Rule of 40 Acres or Less

Horizontal Drainhole Displacement, ft	Additional Acreage Allowed, acres
100 to 585	20
586 to 1,170	40
1,171 to 1,755	60
1,756 to 2,340	80
2,341 to 2,925	100
2,926 to 3,510	120
etc. – 585 ft increments	etc. – 20-acre increments

Additional Acreage Assignment for Fields with a Density Rule Greater Than 40 Acres

Horizontal Drainhole Displacement, ft	Additional Acreage Allowed, acres
150 to 827	40
828 to 1,654	80
1,655 to 2,481	120
2,482 to 3,308	160
3,309 to 4,135	200
4,136 to 4,962	240
etc. – 827 ft increments	etc. – 40-acre increments

2. Specific field rule – Hawkville (Eagleford Shale) Field A = (L x 0.16249) + 320 acres

Additional Acreage Assigned

Spraberry

$$80 + 80 + 240 = 400 \text{ ac.}$$

Barnett Shale

$$320 + 32 + 240 = 592 \text{ ac.}$$

Sugarkane

$$(4200 \times 0.2) + 320 = 1160$$

4200' Lateral

Horizontal terms (rule 86(a)(1-6))

- (1) **Correlative interval**--The depth interval designated by the field rules, by new field designation, or, where a correlative interval has not been designated by the commission, by other evidence submitted by the operator showing the producing interval for the field in which the horizontal drainhole is completed.
- (2) **Horizontal drainhole**--That portion of the wellbore drilled in the correlative interval, between the penetration point and the terminus.
- (3) **Horizontal drainhole displacement**--The calculated horizontal displacement of the horizontal drainhole from the penetration point to the terminus.
- (4) **Horizontal drainhole well**--Any well that is developed with one or more horizontal drainholes having a horizontal drainhole displacement of at least 100 feet.
- (5) **Penetration point**--The point where the drainhole penetrates the top of the correlative interval.
- (6) **Terminus**--The farthest point required to be surveyed along the horizontal drainhole from the penetration point and within the correlative interval.

MINERAL INTEREST POOLING ACT (MIPA)

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OVERVIEW

- Force Pooling Is Based On The Mineral Interest Pooling Act (“MIPA”) Enacted In 1965 But Effective March 8, 1961
- Purposes Of MIPA Is To Protect Correlative Rights, Prevent Waste Or Prevent Drilling Of Unnecessary Well
- Texas Statute Is Unique
 - Designed To Encourage Voluntary Pooling Before Going To Commission
- Prerequisite For Force Pooling- Fair And Reasonable Voluntary Offer To Pool Which Has Not Been Accepted

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MAY I FORCE POOL? PREREQUISITES TO FORCE POOLING

- Established Field
 - No Wildcat Pooling
- Discovery Date of Field after 3/8/1961
- Special Field Rules
- No State Lands Without Consent
- Two or More Tracts
- Common Reservoir or Consolidated Field
- Existing or Proposed Well

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MAY I FORCE POOL?

PREREQUISITES TO FORCE POOLING (CONTINUED)

- **Unit Size Limited**
 - 160 acres for oil well
 - 650 acres + 10% tolerance for gas well
 - Horizontal wells not contemplated
- **Achieve Statutory Purpose**
 - Avoid drilling of unnecessary wells
 - Protect correlative rights
 - Prevent waste
- **Voluntary Offer to Pool**

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PARTIES WHO MAY SEEK TO FORCE POOL

- **Authorized Force Pooling Applicants**
 - Existing Proration Unit-Any Owner including Royalty Owners
 - Proposed Unit – Only Possessory Mineral Owners
- **School Land Board Has Standing to Force Pool Unleased Riverbeds and Channels**
 - GLO/Ammonite actively pursuing force pooling of unleased riverbeds into adjacent production
 - 80+ applications filed – 200 more identified

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VOLUNTARY POOLING OFFER

- Requirement Unique to Texas Law
- Jurisdictional Prerequisite for Force Pooling
- Elements –*Carson v. RRC* held that
 - A fair and reasonable pooling offer takes into account relevant factors important to...
 - A “reasonable person” in the position of the offeree
- RRC Liberally Construes What Constitutes a Fair and Reasonable Offer
 - RRC legal staff recently followed stricter interpretation

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Unfair Offers

- All or none in a proposed 8 well development
- For dual completion, no apportionment of costs and interest between zones
- Attaching form JOA without blanks filled in to offer
- Pooling drillsite royalty on same yardstick basis as others in pooled unit after well drilled
 - *Carson v. RRC* rejected MIPA standard for existing proration units
- Pooling for a reservoir from which existing well is not currently producing

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Fair Offers

- Risk Penalty Not Required
- Drainage of Specific Acreage in Unit Not Required- Only Equivalent
- Timing- Not an Issue If Made Before Hearing
- Statutory-Participation on Same Yardstick Basis as Others in an Existing Unit –*Except for Carson facts*
- Pool, Lease or Farmout for Residential Lots
- Whether Offer to Lease Is Offer to Pool

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ACREAGE SUBJECT TO FORCE POOLING

- MIPA Limits Pooling to Acreage that Is Productive at the Time of Final Order
- But Determination of Productive Acreage Based on the Evidence at the Hearing- Not Updated
- Applies Even for Water Drive Reservoirs with Changing Productive Limits

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Finley Resources Case Expands Traditional Application of MIPA (continued)

- **Opposing Positions**
 - **Finley:** MIPA Unit necessary to drill well to prevent waste, protect correlative rights of working interests and 100's of royalty owners and to prevent drilling unnecessary wells.
 - **Examiners:** MIPA limited to protect small tracts, not to give large tract lessees more flexibility in development.
- **RRC Granted MIPA Application**
 - Action 1+ years after Finley filed application.
 - Granted force pooled parties 1/5 royalty and carried 4/5 working interest.

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Finley Resources Case Expands Traditional Application of MIPA (continued)

- **Significance of *Finley* Decision**
 - Remedy for operators to drill wells over objection of unleased/unfindable parties refusing to lease or pool.
 - Threat of force pooling encourages good faith negotiations – MIPA cases are burdensome for all parties.

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CONCLUSIONS

- MIPA May Have Been Historically Effective To Promote Its Overriding Purpose To Encourage Voluntary Pooling.
- This Result Not Applicable For Unfindable/ Unidentifiable or Unresponsive Owners.
- *Finley* Decision Is An Antidote For This Problem.
- Threat of MIPA Action For Proposed Wells Should Encourage Non-responsive Owners To Negotiate.
- MIPA May be Used to Assist In Drilling Wells Previously Undrillable.

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QUESTIONS?

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