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Voluntary Pooling and Unitization

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PART I. VOLUNTARY POOLING

A. THE LEASE POOLING CLAUSE

Virtually all oil and gas leases have a pooling clause. It is a lengthy provision, but the gist of it can be boiled down to a simple concept and some key phrases.

First, the concept: Imagine a checkerboard with eight alternating black-and-white Squares on each side, containing a total of 64 individual squares. Assume each square contains 10-acres of land, each owned by a different landowner. A lessee, Bigg Oil, secures leases from each of the landowners–64 separate leases–each containing a pooling clause. Bigg Oil exercises its right to pool all 64 tracts into one drilling unit totaling 640 acres and drills a gas well in the middle of the checkerboard. This one well will hold all 64 leases in effect if it produces in paying quantities. Operations on this one well will be treated as if the operations were taking place on each individual square. In sum, one well holds 64 leases.

The production from this unit well will be divided among the 64 owners based on acreage and on the royalty terms of each individual lease. If one landowner's lease contains a 1/8 royalty, he will receive 1/64 x 1/8 of the unit's revenues from production. If a different landowner had bargained for a 1/6 royalty, she will receive 1/64 x 1/6 of the production revenues. Without pooling, only the owner of the center square containing the well would receive royalties. The other tract owners would be drained by this well, particularly if it is a gas well (which typically can drain from an area of 640 acres). The lessee would face lawsuits from the lessors being drained under the implied covenant to protect against drainage. Yet drilling individual wells on each of the 64 squares would either be prohibitively expensive or prohibited by Railroad Commission (RRC) spacing rules. Pooling avoids drilling unnecessary wells and also protects the correlative rights of all owners in the 640-acre unit by giving each a fair share of the proceeds from the unit well.

The scenario can be changed such that each 10-acre square is leased to a different lessee, but each lease has a pooling clause. The 64 different lessees will probably agree to pool their tracts and drill a well together. Each lessee will pay 1/64 of the costs of the well and receive 1/64 of the profits from production. And each lessee will pay its own lessor the proper amount of royalties due under the lease from that lessor. Note: The lessees will probably sign a Joint Operating Agreement (JOA) and appoint one lessee as the operator to drill the well and operate it on behalf of all the working interest owners.

Here is the full text of a typical pooling clause in a lease, with the key language in bolded font:

> ***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 explore, or 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 in and under and that may be produced from said premises. 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, provided that should a governmental authority having jurisdiction prescribe or permit the creation of units larger than those specified, units thereafter created may conform substantially in size with those prescribed or permitted by governmental regulations. Lessee under the provisions hereof may pool or combine acreage covered by this lease, or any portion thereof as above provided as to oil in any one or more strata and as to gas in any one or more strata. The pooling in one or more instances shall not exhaust the rights of the Lessee hereunder to pool this lease or portions thereof into other units. Lessee shall file for record in the appropriate records of the county in which the leased premises are situated an instrument describing and designating the pooled acreage as a pooled unit. Lessee may at its election exercise its pooling option after commencing operations for or completing an oil or gas well on the leased premises, and the pooled unit may include, but it is not required to include, land or leases upon which a well capable of producing oil or gas in paying quantities has theretofore been commenced.* ***Operations for drilling on or production of oil or gas from any part of the pooled unit which includes all or a portion of the land covered by this lease*** *regardless of whether such operations for drilling were commenced or such production was secured before or after the execution of this instrument or the instrument designating the pooled unit,* ***shall be considered as operations for drilling on or production of oil or gas from land covered by this lease whether or not the well or wells be located on the premise covered by the lease,*** *and the entire acreage constituting such unit or units, as to oil and gas, or either of them, as herein provided shall be treated for all purposes, except the payment of royalties on production from the pooled unit, as if the same were included in this lease.* ***For the purpose of computing the royalties*** *to which owners of royalties shall be entitled on production of oil and gas from the pooled*