



MASSIVE MINERALS

Voluntary Pooling, Allocation Wells and Production Sharing Agreements



Roadmap

- Pooling
 - Why do we need it?
 - Rule of capture
 - Unintended consequences
 - Results of pooling
- What to do when you can't pool
 - Production sharing agreements
 - Allocations wells
 - Legal?
 - Risks
 - Allocation of production



Why do we need Pooling?

- Rule of Capture
 - *Pierson v. Post*
 - Wild and migratory
 - Ownership requires possession
 - First in time, First in right
 - Finders Keepers



Unintended consequences ...

- Nature of Oil and Gas
 - “Owner of a tract of land acquires title to the oil or gas which he produces from wells on his land, even though part of the oil or gas may have migrated from adjoining lands.” -*Eliff v. Texon Oil Co.*
 - So...?
 - No consent from adjacent owners to drill.
 - No liability for drainage.
 - How can adjacent owners protect themselves?
 - Drill their own wells.
 - Result ...



Boiler Avenue, Spindletop

- Spindletop dome discovered in 1901.
- 400+ wells by 1903.
- Production
 - 1902: ~50,000 bbl/day
 - 1904: ~10,000 bbl/day
- Massive waste due to over drilling.



YOUR PARTNER IN CREATING MASSIVE, OUTSIZED VALUE



What to do?

- Railroad Commission steps in
 - Rule 37 – Spacing Rule
 - 1919
 - Changed 6 times since
 - 467' lease lines/1,200' wells
 - Rule 38 – Density Rule
 - Minimum acreage
 - Rule 40 – Proration Units
 - Maximum allowables



*"Hi! I'm from the government, and
I'm here to help you!"*

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Voluntary Pooling

A

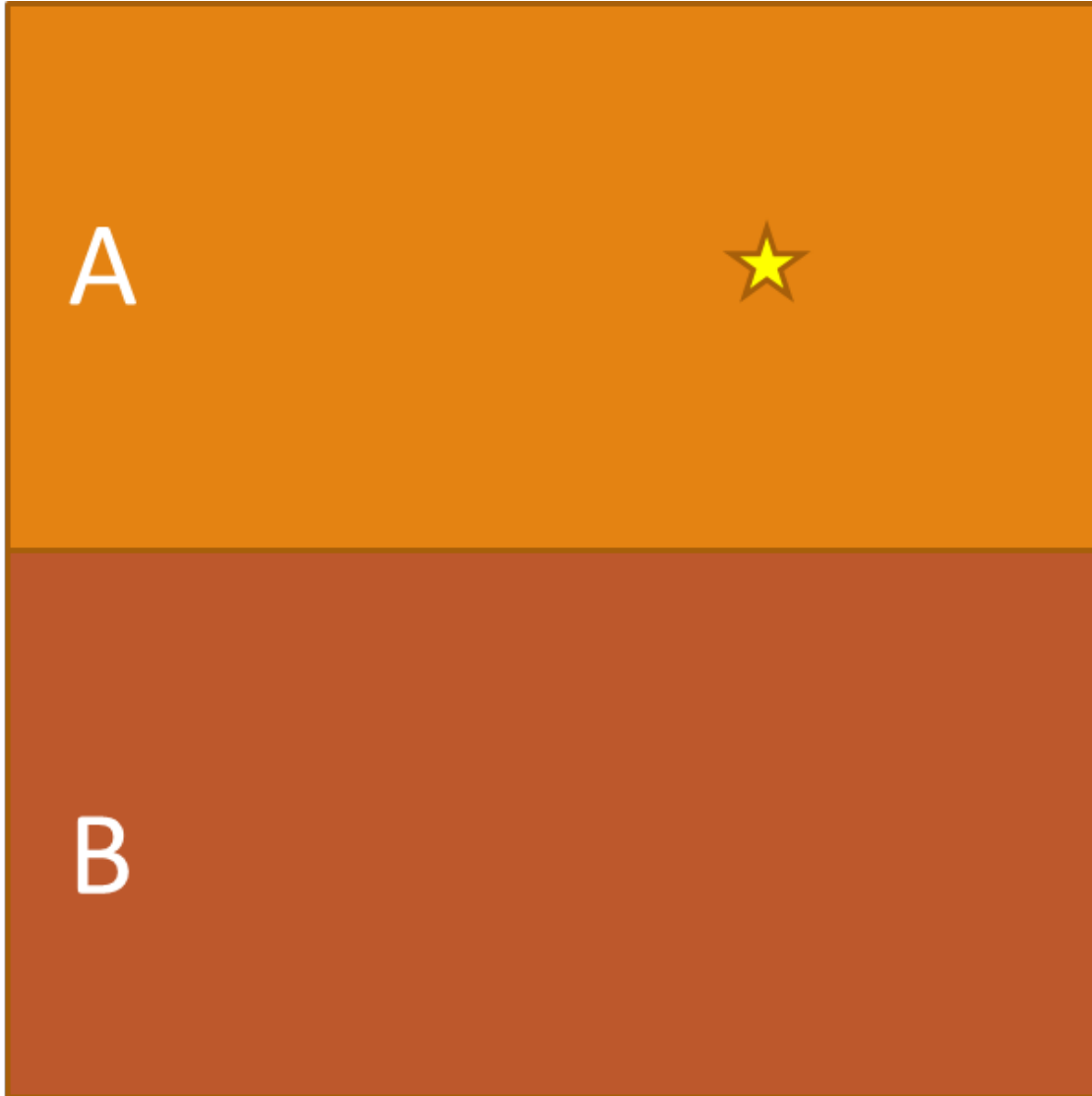


B

What is pooling?

- “Joining together of small tracts for the purpose of having sufficient acreage to receive a drilling permit and for sharing production between owners.”
- Lessee must have authorization
- Where?
 - Community Lease
 - Pooling Agreements
 - MIPA
 - Lease itself

YOUR PARTNER IN CREATING MASSIVE, OUTSIZED VALUE



Why...

- Rule of Non-Appportionment
 - Amelia leases Tracts A & B to Clara
 - Amelia sells Tract B to Bryce
 - Clara drills on Tract A
- Who gets paid?
 - Amelia gets all of the royalty
 - Bryce gets angry at Amelia and Clara
 - RRC Rules prevent additional wells
 - Bryce is out of luck
- Pooling bails Bryce out



Results of Voluntary Pooling

- Benefits to Lessee:
 - Leases extended
 - Pugh? Horizontal Severance?
 - Commencement of well excuses payment of delay rentals
 - Production from well relieves obligation to pay delay rentals
 - Relieved of covenant to reasonably develop each tract separately
 - Wells located without reference to property lines
 - Relieved of obligation to prevent drainage



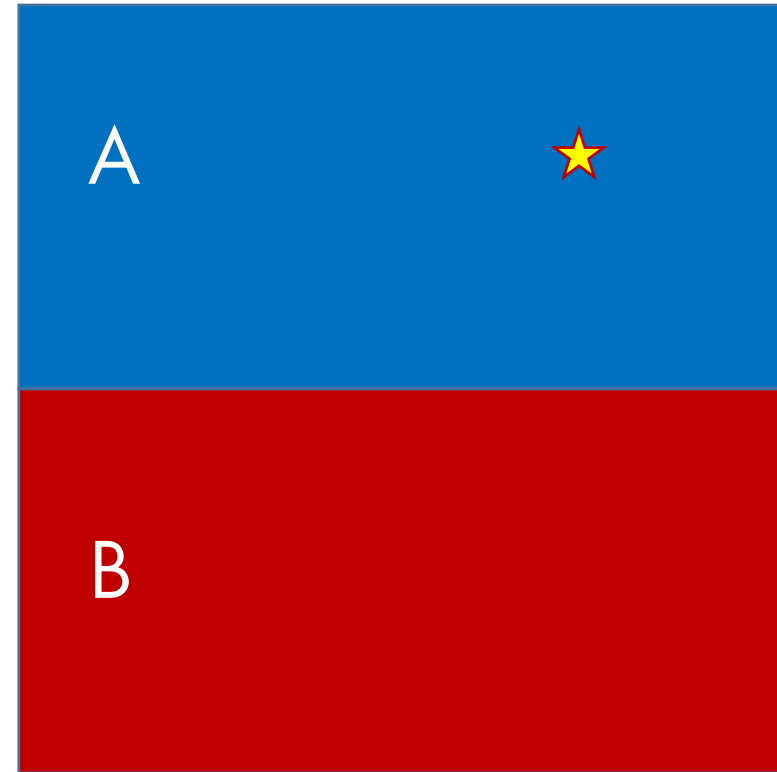
Results of Voluntary Pooling

- Lessors relinquish:
 - Right to have their own tracts developed separately
 - Receive all of the royalties from wells on their tract
 - Right to drill offsetting wells draining his tract
- Lessors gains the right to share proportionately in royalties.
 - Cross-conveyance of interests
 - NPRI's/NEMI's?



Scenario — No Pooling

- Operator leases Amelia & Bryce
 - 1/4 Royalty
- Does not pool
- Drills well on Tract A
- Result:
 - A gets full 1/4 RI
 - O gets 3/4 NRI
 - B gets nothing.
 - Drill on Tract B.
 - Let B's lease lapse.



● = 80 acres

● = 80 acres

★ = well



Scenario — Operator Pools

- Operator leases Amelia & Bryce
 - 1/4 Royalty
- Pools A & B for permit
- Drills well on Tract A
- Result:
 - A & B each get $1/4 \text{ RI} \times 50\% = 1/8$
 - O gets $3/4 \text{ NRI}$



● = 80 acres

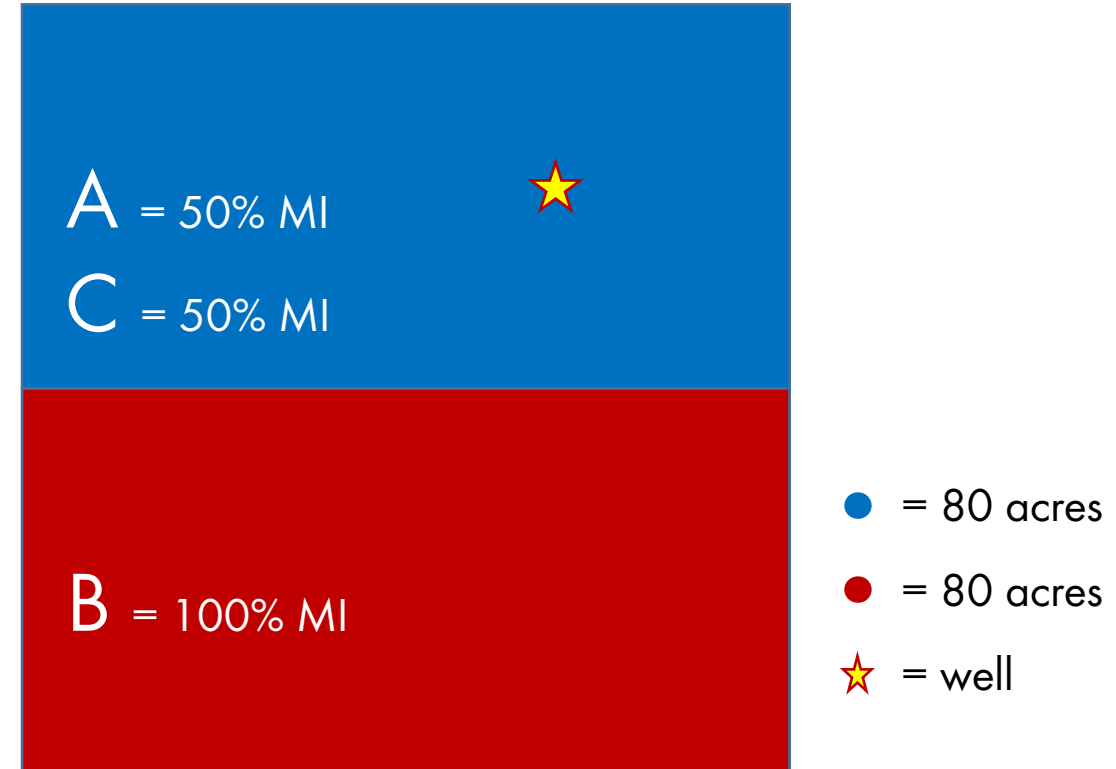
● = 80 acres

★ = well



Scenario — Operator Pools w/unleased MI

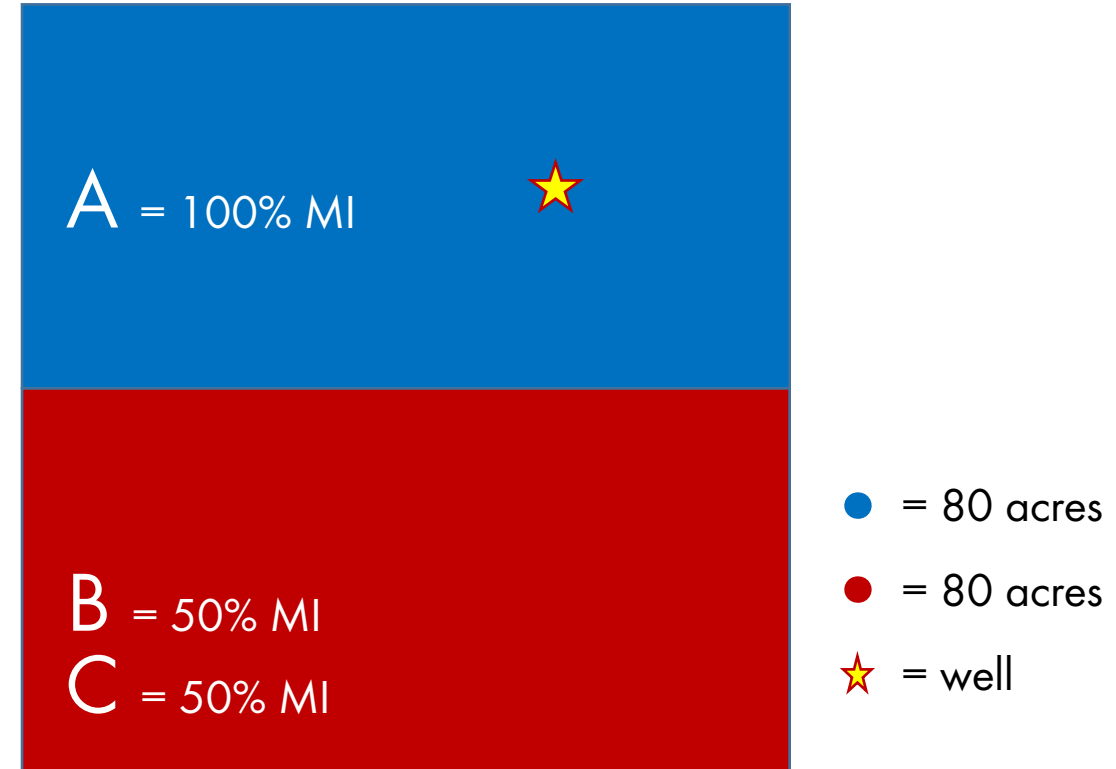
- Operator leases Amelia & Bryce
 - 1/4 Royalty
- Clara remains unleased
- Pools A & B for permit
- Drills well on Tract A
- Result:
 - A gets $1/4 \text{ RI} \times 25\% = 1/16$
 - B gets $1/4 \text{ RI} \times 50\% = 1/8$
 - C gets:
 - Nothing BPO
 - 50% of all production APO
 - O gets:
 - $3/4 \text{ NRI} \times 75\% + 25\% \text{ BPO} = 13/16$
 - $3/4 \text{ NRI} \times 75\% - 25\% \text{ APO} = 5/16$
- Should Clara lease?





Scenario — Operator Pools w/unleased MI

- Operator leases Amelia & Bryce
 - 1/4 Royalty
- Clara remains unleased
- Pools A & B for permit
- Drills well on Tract A
- Result:
 - A gets $1/4 \text{ RI} \times 50\% = 1/8$
 - B gets $1/4 \text{ RI} \times 25\% = 1/16$
 - C gets nothing...Why? (*Superior Oil Co. v. Roberts*)
 - O gets $3/4 \text{ NRI} + 1/16 \text{ UMI}$ (Escheat)





Scenario — Operator Pools w/NPRI

- Operator leases Amelia & Bryce
 - 1/4 Royalty
- Pools Tracts A & B for permit
- Drills well on Tract A
- Clara refuses to ratify
- Result:
 - A gets $1/4 \text{ RI} \times 50\% \text{ less } 1/16 = 1/16$
 - B gets $1/4 \text{ RI} \times 50\% = 1/8$
 - C gets undiluted $1/16$
 - O gets $3/4$

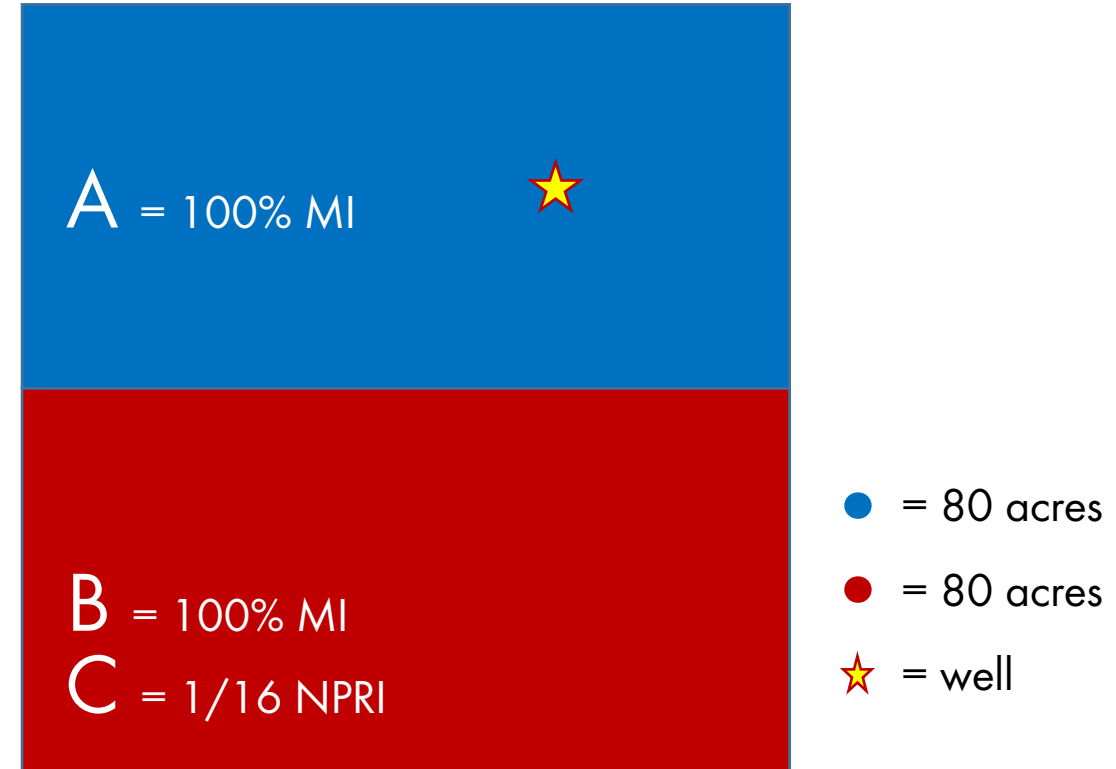


- = 80 acres
- = 80 acres
- ★ = well



Scenario — Operator Pools w/NPRI

- Operator leases Amelia & Bryce
 - 1/4 Royalty
- Pools A & B for permit
- Drills well on Tract A
- Clara ratifies Bryce's Lease
- Result:
 - A gets $1/4 \text{ RI} \times 50\% = 1/8$
 - B gets $1/4 \text{ RI} \times 50\% \text{ less } 1/16 \times 50\% = 3/32$
 - C gets $1/16 \times 50\% = 1/32$
 - O gets $3/4$
- Can UMI owner ratify? (*Superior*)





What to do when you can't pool...?

YOUR PARTNER IN CREATING MASSIVE, OUTSIZED VALUE



Production Sharing Agreements

- What is a PSA?
 - Agreement between owners allocating production
 - Different methods of allocation
 - May include other covenants regarding drilling and production
 - Include relevant definitions
- When are PSAs used
 - Horizontal wells
 - Laterals drilled with certain orientation
 - Existing pooled units/unpooled interests not configured properly
 - RRC requires >65%
- Agreement controls allocation of production



Types of PSAs

- Single Well PSA
 - Between all owners of all tracts
 - Allocation usually based on footage
- Designated Area PSA
 - Large area comprised of multiple pooled/unpooled tracts
 - Often incorporates tradition surface acreage allocation
- Sharing Well PSA
 - No specific acreage-open ended
 - Sharing Well if the productive drainhole crosses separate tracts
 - Usually an amendment to existing OGL
 - Expands Lessee's pooling authority
 - Flexibility in locating future wells
 - Most desirable for Lessee



Are Allocation Wells Legal?

Yes

- Operator has right to drill wells
 - From lease line to lease line
- Crossing lease lines does not equal pooling
- Leases don't prevent
- Potential Waste
- Question is proper payment of royalties

No

- Combining tracts = pooling
- Lease must permit pooling for multi-tract drilling
- Remedies
 - Cancellation of permit
 - Slander of title
 - Injunction
 - Damages



Ruling?

- Klotzman case
 - EOG owned 100% WI
 - Asked for permit from RRC
 - Examiners recommended denial of permit
 - Commissioners overruled
 - Single finding of fact: 100% WI gives EOG good faith claim to drill.
- RRC makes no claim to allocation of production.
- Devon/Monroe Properties Complaint



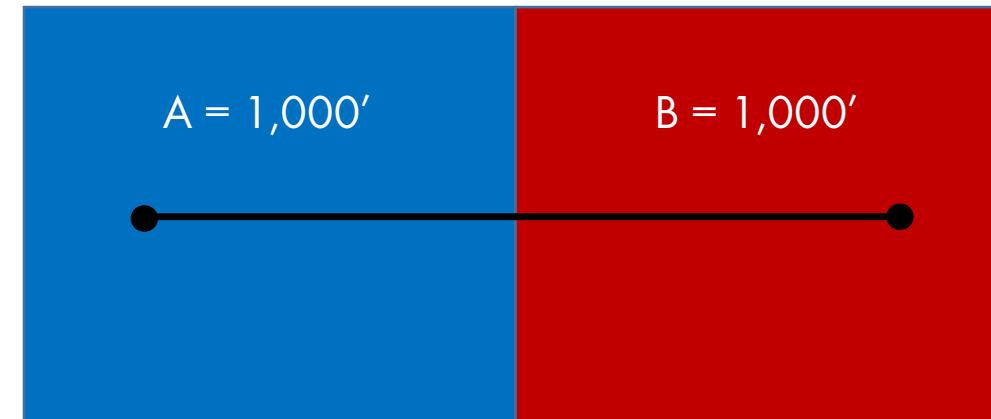
Risks in Allocating Production

- With unsigned PSA wells and Allocation wells:
 - Each tract entitled to minerals produced
 - 100% of wellbore production
 - Caselaw shows unlikely
 - So who gets what – *Browning Oil Co. v. Luecke*
 - Owners can only claim royalties from their own drillsite tracts
 - Recover royalties attributable to their tracts with **reasonable probability**
 - Burden is on the Lessor/Mineral Owner
- How to calculate?



Length of wellbore

- Clara leases Amelia & Bryce
 - $\frac{1}{4}$ RI
- No pooling allowed
- Drills allocation well
- Allocates production based on wellbore length
- Result:
 - A & B each get $\frac{1}{4}$ RI \times 50% = $\frac{1}{8}$
 - C gets $\frac{3}{4}$



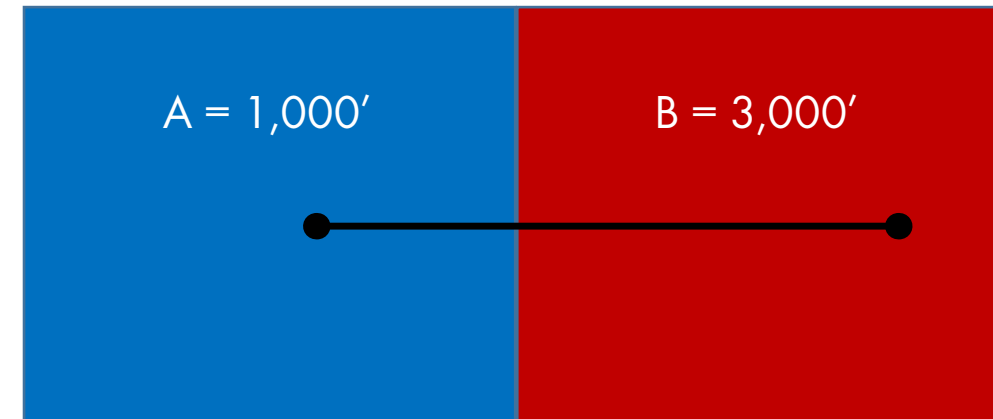
● = 80 acres

● = 80 acres



Length of wellbore — modified

- Clara leases Amelia & Bryce
 - 1/4 RI
- No pooling allowed
- Drills allocation well
- Allocates production based on wellbore length
- Result:
 - A gets $1/4 \text{ RI} \times 25\% = 1/16$
 - B gets $1/4 \text{ RI} \times 75\% = 3/16$
 - C gets $3/4$



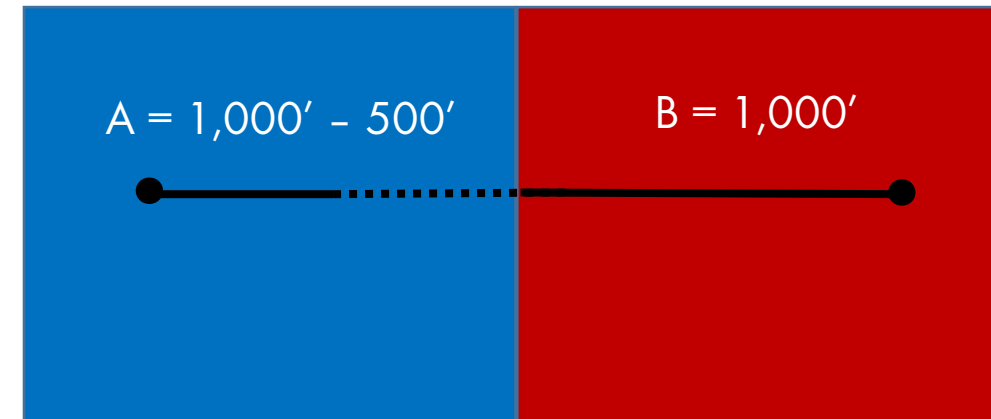
● = 80 acres

● = 80 acres



Length of wellbore – NPZs

- Clara leases Amelia & Bryce
 - 1/4 RI
- No pooling allowed
- Drills allocation well
 - Includes Non-perforation zones
- Allocates production on:
 - Wellbore length - NPZs
- Result:
 - A gets $1/4 \text{ RI} \times 1/3 = 1/12$
 - B gets $1/4 \text{ RI} \times 2/3 = 1/6$
 - C gets $3/4$



● = 80 acres

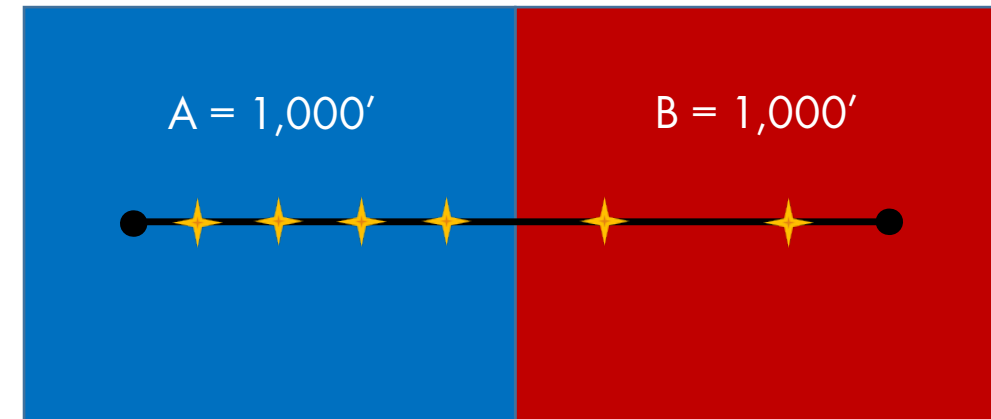
● = 80 acres

.... = NPZ



Take Points

- Clara leases Amelia & Bryce
 - 1/4 RI
- No pooling allowed
- Drills allocation well
- Allocates production based on take points
 - Any point along the wellbore
 - Where oil/gas can be produced
- Result:
 - A gets $1/4 \text{ RI} \times 4/6 = 1/6$
 - B gets $1/4 \text{ RI} \times 2/6 = 1/12$
 - C gets $3/4$

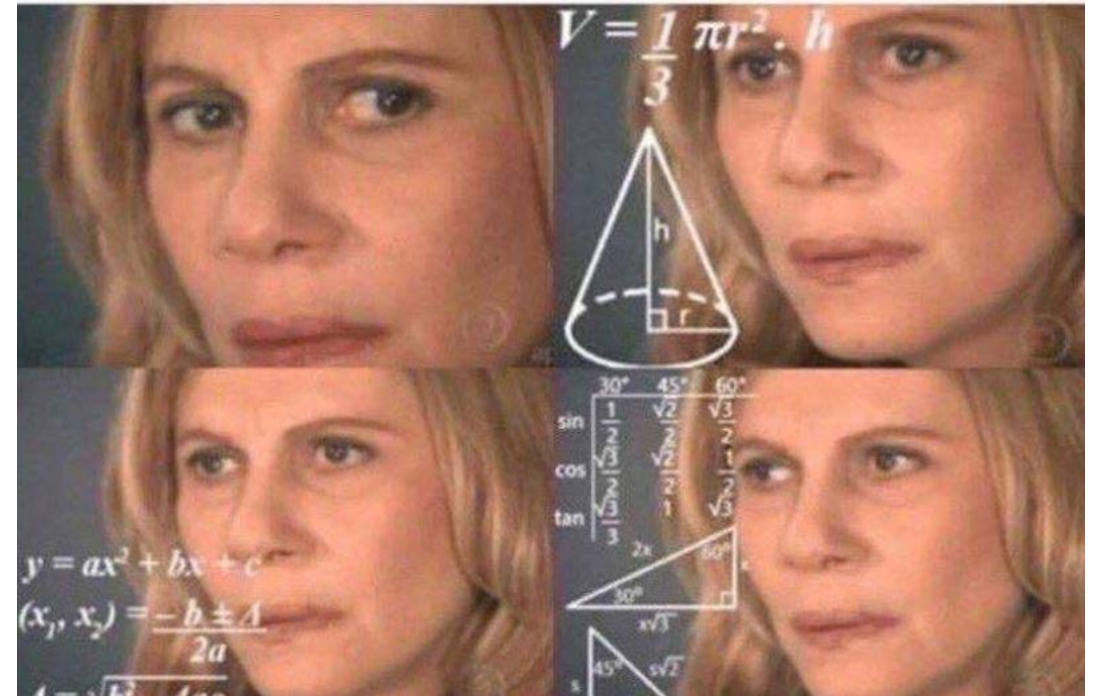


- = 80 acres
- = 80 acres
- ★ = Take Point



So what to do ...

- Which route to go?
 - Allocation permitting is simpler
 - Klotzman compared to getting driver's license
- No caselaw on allocation
 - Or whether they constitute pooling
 - Cases have settled
- What to do?
 - Allocation based on stimulated portion of a productive wellbore is most common.
 - Need caselaw
 - Legislative fix





QUESTIONS?

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