

# OIL AND GAS LEASES AND POOLING: A LOOK BACK AND A PEEK AHEAD

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## I. INTRODUCTION

With the renaissance of onshore, domestic oil and gas production principally through the development of long-known, but heretofore inaccessible, shale reservoirs containing both oil and gas, the standard provisions contained in the oil and gas lease have been put to the test and, in many ways, have come up short. One such standard provision—the pooling clause—appears to be ripe for change.<sup>1</sup> Another leasehold provision—the unitization clause—which is rarely found in Texas or the Mid-Continent Region, also needs to be revisited in order to make the oil and gas lease a more effective instrument from both the lessor’s and lessee’s perspectives as we move forward in the twenty-first century. I use the terms pooling clause and unitization clause as I would the terms pooling and unitization, namely that a pooling clause is one that will allow the “joining together of small tracts or portions of tracts for the purpose of having sufficient acreage to receive a well drilling permit under the relevant state or local spacing laws and regulations.”<sup>2</sup>

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1. For textual treatment of the leasehold pooling clause, see 4 PATRICK H. MARTIN & BRUCE M. KRAMER, WILLIAMS & MEYERS OIL AND GAS LAW §§ 669-670 (4th ed. 2010) [hereinafter MARTIN & KRAMER, OIL & GAS]; 1 BRUCE M. KRAMER & PATRICK H. MARTIN, THE LAW OF POOLING AND UNITIZATION 8-1 to -51 (3d ed. 2012) [hereinafter KRAMER & MARTIN, LAW OF POOLING]; 4 EUGENE KUNTZ, THE LAW OF OIL AND GAS § 48.3 (2012); 1 ERNEST E. SMITH & JACQUELINE LANG WEAVER, TEXAS LAW OF OIL AND GAS § 4.8[B][2] (2d ed. 2010).

2. KRAMER & MARTIN, LAW OF POOLING, *supra* note 1, at 1-2 to -3. In *Freeman v. Samedan Oil Corp.*, 78 S.W.3d 1 (Tex. App.—Tyler 2001, no pet.), the court found that, even though the pooling clause expressly gave the lessee the power to both pool and unitize, the clause, interpreted in its entirety, did not authorize the lessee to commit a pooled unit into a voluntary fieldwide secondary recovery unit. *Id.* The court focused on the language “drilling or production units” in the clause to preclude the lessee from unitizing the acreage. *Id.*

On the other hand, a unitization clause is one that will allow “the consolidation of . . . leasehold interests covering all or part of a common source of supply.”<sup>3</sup>

This Article will provide some historical background on the development and use of the leasehold pooling clause; review interpretational issues that have impacted the clause; review the court-imposed standards of conduct on a lessee’s exercise of the pooling power; and, finally, make some recommendations regarding how pooling and unitization clauses can be utilized to deal with the reality of horizontal wellbores, larger spacing units, and the to-date imperfect information regarding drainage patterns that occur after shales and other formations have been hydraulically fractured.

## II. HISTORICAL BACKGROUND

Because of the nexus between pooling and spacing regulation, pooling clauses did not begin to appear in oil and gas leases until the late 1920s and early 1930s when state oil and gas conservation agencies were beginning to impose minimum spacing and acreage requirements before a permit to drill an oil or gas well would be issued.<sup>4</sup> A leading oil and gas treatise published in 1926 provides thirteen model oil and gas lease forms, and none of them contain a pooling clause.<sup>5</sup> One of the earliest reported cases that reflects that a pooling clause was included in the lease is *Imes v. Globe Oil & Refining Co.*<sup>6</sup> In that 1938 Oklahoma case, the court referred to a part of a pooling clause contained in a lease that was executed no later than 1931.<sup>7</sup> The pooling clause provided in part,

It is further agreed that lessee may at any time without the consent of lessors, consolidate, jointly operate, and develop this lease and the land covered hereby with any other lease or leases covering any lot, lots or parcels of land embraced within the outer boundary lines of the J. W. Craig’s Sub. of Block 19, Fruitland Addition to Oklahoma City, Oklahoma.<sup>8</sup>

The pooling clause was contained in a community lease, which had the effect of pooling all of the separately owned tracts of the lessors.<sup>9</sup> This pooling clause, however, expanded the lessee’s right to pool just the tracts described in the

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3. KRAMER & MARTIN, LAW OF POOLING, *supra* note 1, at 1-3.

4. The Railroad Commission of Texas adopted Rule 37 in 1919, but its constitutionality was not established until 1935. SMITH & WEAVER, *supra* note 1, § 9.3; see *Brown v. Humble Oil & Ref. Co.*, 83 S.W.2d 935 (Tex. 1935).

5. See LAWRENCE MILLS & J. C. WILLINGHAM, THE LAW OF OIL AND GAS 601-43 (1926). It is also interesting that there is not an index entry for either “pooling” or “unitization” in the Mills and Willingham treatise. See *id.*

6. See *Imes v. Globe Oil Ref. Co.*, 84 P.2d 1106 (Okla. 1938).

7. *Id.* at 1107.

8. *Id.* (internal quotation marks omitted).

9. *Id.*

community lease to a larger area outside of the community lease tracts.<sup>10</sup> It is also interesting to note that, at least in this excerpted portion of the pooling clause, there were no acreage limitations or tie-ins to Oklahoma Corporation Commission or Oklahoma City spacing regulations.<sup>11</sup>

By the 1950s, pooling clauses were becoming more ubiquitous and were the subject of substantial commentary.<sup>12</sup> Some of the early concerns, such as trying to limit the pooling power to a defined or fixed period in order to avoid running afoul of the Rule Against Perpetuities, are no longer issues.<sup>13</sup> Two cases in the early 1950s, however, dispelled the claim that an unlimited-in-duration pooling power would violate the Rule.<sup>14</sup> The issue of whether the pooling power would be exhausted after it was exercised once was also a concern, but that issue was dealt with by drafting language into the lease that the pooling power could be exercised “from time to time.”<sup>15</sup> In these early days, it was also common for pooling clauses to be tied into state spacing regulation, limited as to acreage, and conditioned upon the filing of a declaration of pooling.<sup>16</sup>

Early pooling clauses tended to be lengthy and to fully explain the ramifications of the exercise of the pooling power. The following is a typical example of the type of pooling clauses inserted into Texas leases in the 1950s:

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 with other land, lease or leases in the immediate vicinity thereof, when in Lessee's judgment it is necessary or advisable to do so in order properly to develop and operate said 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 the oil and gas in and under and that may be produced from said premises. Lessee shall execute in writing an instrument identifying and describing the pooled acreage. The entire acreage so pooled into a tract or unit shall be treated, for all purposes except the payments of royalties on production from the pooled unit, as if it were included in this lease. If production is found on the pooled acreage, it shall be treated as if production is had from this lease, whether the

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10. *Id.*

11. *See id.*

12. *See* ROBERT SULLIVAN, HANDBOOK OF OIL AND GAS LAW 150-55 (1955); Niles Chubb, *The Pooling Clause in an Oil and Gas Lease*, 22 ROCKY MTN. L. REV. 510 (1950); Ralph B. Shank, *Pooling Problems*, 28 TEX. L. REV. 662 (1950); Ralph B. Shank, *Some Legal Problems Presented by the Pooling Provisions of the Modern Oil and Gas Lease*, 23 TEX. L. REV. 150 (1945).

13. *See* Chubb, *supra* note 12, at 510-11.

14. *Phillips Petrol. Co. v. Peterson*, 218 F.2d 926, 931 (10th Cir. 1954); *Kenoyer v. Magnolia Petrol. Co.*, 245 P.2d 176, 179 (Kan. 1952). These cases are discussed at length in MARTIN & KRAMER, OIL & GAS, *supra* note 1, § 670.1.

15. Chubb, *supra* note 12, at 511; KRAMER & MARTIN, LAW OF POOLING, *supra* note 1, § 8.03; *see also* *Texaco, Inc. v. Lettermann*, 343 S.W.2d 726, 731 (Tex. Civ. App.—Amarillo 1961, writ ref'd n.r.e.).

16. Chubb, *supra* note 12, at 511. A number of pooling clauses may be found in KRAMER & MARTIN, LAW OF POOLING, *supra* note 1, § 8.02; MARTIN & KRAMER, OIL & GAS, *supra* note 1, § 669.

well or wells be located on the premises covered by this lease or not. In lieu of the royalties elsewhere herein specified, Lessor shall receive on production from a unit so pooled only such portion of the royalty stipulated herein as the amount of his acreage placed in the unit or his royalty interest therein on an acreage basis bears to the total acreage so pooled in the particular unit involved.<sup>17</sup>

Many of these early pooling provisions contained extensive descriptions of the effects of a pooling on the leasehold obligations of the lessee.<sup>18</sup> This particular clause appears to be broader than other clauses of this era.<sup>19</sup> It purports to leave the decision to pool solely to the discretion or judgment of the lessee.<sup>20</sup> It also expands the reasons why a lessee may pool the lessor's royalty interest to go beyond just compliance with Railroad Commission spacing regulations.<sup>21</sup> That forward-looking provision allows the lessee to pool in order to "promote the conservation of the oil and gas."<sup>22</sup> That language clearly allows the lessee to pool acreage for an oil well, something that many pooling clauses did not permit, and it further might even allow the lessee to unitize the lease because it would serve the purpose of conserving oil and gas.<sup>23</sup>

Because most pooling clauses, as well as the common law of pooling, would allow the entire lease to be held by production or other activities or operations on pooled-unit lands, lessors, starting in the 1940s, began to negotiate what became known as "Pugh" clauses or "Freestone riders" into oil and gas leases in order to segregate the lease into pooled and non-pooled segments.<sup>24</sup> Pugh clauses continue to be used to this day as a means of protecting the lessor's interests from being diluted and, thus, can be seen as being the ancestor of modern "anti-dilution" provisions that are very prevalent today.<sup>25</sup>

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17. *Tiller v. Fields*, 301 S.W.2d 185, 187 (Tex. Civ. App.—Texarkana 1957, no writ) (internal quotation marks omitted). A nearly identical clause is found in the lease in controversy in *Skelly Oil Co. v. Harris*, 352 S.W.2d 950 (Tex. 1962).

18. See KRAMER & MARTIN, *LAW OF POOLING*, *supra* note 1, at ch. 8.

19. See *Tiller*, 301 S.W.2d at 188 (highlighting another natural resources pooling clause of that era).

20. *Id.* at 187.

21. *Id.*

22. *Id.*

23. See, e.g., *Sunac Petrol. Corp. v. Parkes*, 416 S.W.2d 798, 802 (Tex. 1967) (providing an example of a pooling clause that limited the lessee's power to pool for gas wells only, leading to a disastrous result for the lessee).

24. KRAMER & MARTIN, *LAW OF POOLING*, *supra* note 1, § 9.01. The appellation "Pugh" clause arises from the name of a Crowley, Louisiana attorney, Lawrence Pugh, who had such clauses placed in leases. *Id.* Apparently, however, clauses segregating the lease into pooled and unpooled areas antedated Mr. Pugh's use of the clause in a 1947 lease. See *Rist v. Westhoma Oil Co.*, 385 P.2d 791, 795 (Okla. 1963); *Thomas M. Bergstedt & Daniel T. Murchison*, Comment, *The Effect of Unitization on the Duration and Extent of Mineral Interests in Louisiana*, 36 TUL. L. REV. 769, 793-94 (1962); see, e.g., *Broussard v. Phillips Petrol. Co.*, 160 F. Supp. 905, 907 (W.D. La. 1958), *aff'd*, 265 F.2d 221 (5th Cir. 1959); *Fremaux v. Buie*, 212 So. 2d 148, 149 n.1 (La. Ct. App. 1968). The term "Freestone rider" is derived from Freestone County, Texas, where it was apparently in widespread use. KRAMER & MARTIN, *LAW OF POOLING*, *supra* note 1, § 9.01 n.3.

25. See *Bergstedt & Murchison*, *supra* note 24, at 794.

Clauses that segregate leasehold acreage into pooled/unitized or non-pooled/non-unitized segments serve to encourage development of the entire leasehold estate.<sup>26</sup> The following is an example of a Pugh clause:

Notwithstanding anything to the contrary herein contained, drilling operations on or production from a pooled unit or units established under the provisions of Paragraph 4 hereof embracing land covered hereby and other land shall maintain this lease in force and effect only as to land included in such unit or units.<sup>27</sup>

Pugh clauses—as well as retained acreage clauses—replace the lessor's need to utilize the implied covenant of reasonable development as the sole means to see that its acreage is fully developed.<sup>28</sup> Furthermore, leases—especially those containing a substantial amount of acreage—will have continuous development clauses that require the lessee to engage in such continuous development; if they do not, all leasehold acreage not held by an existing well or lands within a pooled unit that are held by production is deemed not to be held by production.<sup>29</sup>

### III. BASIC POOLING JURISPRUDENCE

Without a pooling clause, the lessee could pool its leasehold interest but would be powerless to pool the royalty interest or the possibility of reverter.<sup>30</sup> Thus, a lessee would be free to execute a joint operating agreement (JOA) with other working-interest owners but would be faced with the reality that, while development would be governed by the JOA, the lessor would be entitled to enforce the lease as written.<sup>31</sup> This would mean that if the well is located on the pooled tract, the lessor would be entitled to its full royalty and that if the well is located on the non-pooled tract, the leasehold habendum clause would not be satisfied.<sup>32</sup> As the Texas Supreme Court noted, “Absent express authority, a lessee has no power to pool interests in the estate retained by the lessor with those of other lessors.”<sup>33</sup>

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26. MARTIN & KRAMER, OIL & GAS, *supra* note 1, § 9.01.

27. *Shown v. Getty Oil Co.*, 645 S.W.2d 555, 557 (Tex. App.—San Antonio 1982, writ ref'd) (internal quotation marks omitted). Pugh clauses are discussed in depth in KRAMER & MARTIN, LAW OF POOLING, *supra* note 1, §§ 9.01-07.

28. *See Parten v. Cannon*, 829 S.W.2d 327, 329 (Tex. App.—Waco 1992, writ denied). Retained acreage clauses were originally drafted to prevent the lessee from losing those portions of a lease that had productive wells located thereon if the rest of the lease terminated. MARTIN & KRAMER, OIL & GAS, *supra* note 1, at 902-03. The term has expanded its meaning to include clauses that require the release of all acreage that, at the end of the primary term, is not within a drilling, spacing, or proration unit.

29. MARTIN & KRAMER, OIL & GAS, *supra* note 1, § 617.

30. *See Knight v. Chic. Corp.*, 188 S.W.2d 564, 566-67 (Tex. 1945).

31. *Id.* at 566; *see* KRAMER & MARTIN, LAW OF POOLING, *supra* note 1, § 9.01.

32. *Knight*, 188 S.W.2d at 566; *see* *Bruce v. Ohio Oil Co.*, 169 F.2d 709 (10th Cir. 1948).

33. *Jones v. Killingsworth*, 403 S.W.2d 325, 328 (Tex. 1965) (citing *Brown v. Smith*, 174 S.W.2d 43 (Tex. 1943)); *accord* *Se. Pipe Line Co. v. Tichacek*, 997 S.W.2d 166, 170 (Tex. 1999).

In Texas, there appears to be a basic disagreement regarding how pooling clauses are to be interpreted. One Texas court of appeals takes the following approach:

Anticipatory provisions in leases for the commitment by the lessee of such leases to unitization, of necessity must be in general terms. Neither the lessor nor the lessee has any way of knowing at the time the lease is taken the facts with respect to which it will be necessary for the lessee to apply his power. It is not practicable for the lessee to await the ascertainment of such facts. He knows from experience that because of the possibility of many changes in ownership of the lessor's interest as time goes on, it may be difficult to effect an agreement if the right to unitize is not included in the lease itself.<sup>34</sup>

Another court has taken the position that pooling clauses, “[i]n the absence of clear language to the contrary, . . . should not be construed in a narrow or limited sense.”<sup>35</sup> There are other cases as well that advance the position that pooling should be upheld if at all possible.<sup>36</sup>

But on the other hand, there are decisions that interpret pooling clauses narrowly or strictly, hewing closely to the language used by the parties.<sup>37</sup> This interpretational device is often expressed as requiring strict compliance with the express terms of the pooling clause if the pooling is to be valid.<sup>38</sup> It is clear that the Texas Supreme Court in *Jones v. Killingsworth* eschewed the opportunity to make a “savings” construction of the lease pooling clause, which used awkward language regarding spacing units that were permitted or prescribed.<sup>39</sup>

It is my view that, while the courts could—and do—require strict compliance with any clear, concise, and express conditions precedent to the exercise of the pooling power, the interpretation of the pooling clause should be construed in light of the purpose of the clause, which is to encourage the

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34. *Expando Prod. Co. v. Marshall*, 407 S.W.2d 254, 260 (Tex. Civ. App.—Fort Worth 1966, writ ref'd n.r.e.) (internal quotation marks omitted); *accord Young v. Amoco Prod. Co.*, 610 F. Supp. 1479, 1483 (E.D. Tex. 1985); *Mengden v. Peninsula Prod. Co.*, 544 S.W.2d 643, 647 (Tex. 1976); *Sabre Oil & Gas Corp. v. Gibson*, 72 S.W.3d 812, 816 (Tex. App.—Eastland 2002, pet. denied); *Elliott v. Davis*, 553 S.W.2d 223, 226 (Tex. Civ. App.—Amarillo 1977, writ ref'd n.r.e.); *Texaco, Inc. v. Lettermann*, 343 S.W.2d 726, 732 (Tex. Civ. App.—Amarillo 1961, writ ref'd n.r.e.); *Tiller v. Fields*, 301 S.W.2d 185, 187-88 (Tex. Civ. App.—Texarkana 1957, no writ).

35. *Sabre Oil & Gas Corp.*, 72 S.W.3d at 816.

36. *See, e.g., Cambridge Prod., Inc. v. Geodyne Nominee Corp.*, 292 S.W.3d 725, 728, 732-33 (Tex. App.—Amarillo 2009, pet. denied) (refusing to allow a top lessee to challenge the validity of the pooling that was accomplished many years prior to the execution of the top lease under the quasi-estoppel doctrine because the top lessor had accepted pooled unit royalties for many years).

37. *See, e.g., Tittizer v. Union Gas Corp.*, 171 S.W.3d 857, 861 (Tex. 2005); *Tichacek*, 997 S.W.2d at 170; *Jones*, 403 S.W.2d at 327-28.

38. *See, e.g., Tichacek*, 997 S.W.2d at 170; *Union Gas Corp. v. Gisler*, 129 S.W.3d 145, 151 (Tex. App.—Corpus Christi 2003, no pet.); *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 640 (Tex. App.—Austin 2000, pet. denied); *Circle Dot Ranch, Inc. v. Sidwell Oil & Gas, Inc.*, 891 S.W.2d 342, 346 (Tex. App.—Amarillo 1995, writ denied); *Humble Oil & Ref. Co. v. Kunkel*, 366 S.W.2d 236, 239 (Tex. Civ. App.—San Antonio 1963, writ ref'd n.r.e.).

39. *See Jones*, 403 S.W.2d at 327-28.

pooling of interests.<sup>40</sup> There is a third way to approach the interpretational issue, and that is to merely apply the standard canons of construction to the pooling clause, which neither liberally nor narrowly construes such clauses.<sup>41</sup> That approach was taken in *HS Resources, Inc. v. Wingate*, but the court limited its application because it also made reference to the notion that the conditions precedent to pooling must be strictly complied with before the pooling will be effective.<sup>42</sup>

This interpretational inconsistency makes it even more important that pooling clauses be clearly written to reflect the agreement between the lessor and lessee. This is especially true when the parties are limiting the pooling power by placing conditions precedent on its exercise or restricting how, when, or why the pooling power may be exercised.

In most pooling clauses, there is no express duty on behalf of the lessee to exercise the pooling power under a general standard of conduct. Many pooling clauses contain language giving the lessee broad discretion to pool the leasehold acreage.<sup>43</sup> Notwithstanding the lack of any express duties, courts have imposed upon lessees holding the pooling power a duty to exercise that power in “good faith.”<sup>44</sup> While labeling the duty with a “subjective” standard, there is language in the cases that would suggest that the duty is closer to that of “fair dealing” or the objective reasonably prudent operator standard.<sup>45</sup> For example, in *Circle Dot Ranch, Inc. v. Sidwell Oil & Gas, Inc.*, the court described the duty as follows:

Although the facts and circumstances in a given situation of pooling will dictate the obligations of a reasonably prudent operator, the authorities agree that the lessee’s primary obligation is to exercise the pooling power “in good faith, taking into account the interests of both lessee and lessor.”<sup>46</sup>

Traditionally, a good-faith standard is subjective in nature and does not necessarily require the person subject to the standard to take into consideration the interests of the party to whom the duty is owed.<sup>47</sup> The language obviously comes from the reasonably prudent operator standard for implied covenants but would, at a minimum, create some confusion in the appropriate jury instruction.

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40. See MARTIN & KRAMER, OIL & GAS, *supra* note 1, § 670.

41. See *HS Res., Inc. v. Wingate*, 327 F.3d 432, 442 (5th Cir. 2003).

42. *HS Res.*, 327 F.3d at 442 (applying Texas law).

43. See MARTIN & KRAMER, OIL & GAS, *supra* note 1, § 669.2.

44. See SMITH & WEAVER, *supra* note 1, § 4.8[C][1]. Both the *Williams & Meyers* treatise and the *Law of Pooling and Unitization* label the duty one of “fair dealing.” MARTIN & KRAMER, OIL & GAS, *supra* note 1, § 670.2; KRAMER & MARTIN, LAW OF POOLING, *supra* note 1, § 8.06.

45. *E.g.*, *Circle Dot Ranch, Inc. v. Sidwell Oil & Gas, Inc.*, 891 S.W.2d 342, 346 (Tex. App.—Amarillo 1994, writ denied).

46. *Id.* (citation omitted) (quoting *Elliott v. Davis*, 553 S.W.2d 223, 227 (Tex. Civ. App.—Amarillo 1977, writ denied)) (internal quotation marks omitted).

47. Kendor P. Jones & Jennifer L. McDowell, *Keeping Your Lease Alive in Good Times and in Bad*, 55 ROCKY MTN. MIN. L. INST. 23-1, 23-12 (2009).

Would the honest-but-stupid operator who exercises the pooling power consistent with a good-faith or honest belief that it is in the operator's best interest fail the good-faith test because it did not consider the lessor's interest? If the well is planned to be on the lease being pooled, it is never in the lessor's interest to pool because that would dilute its interest, but by giving the lessee the power to pool, the lessor has already consented to such a dilution.

The Tenth Circuit made a good statement of the good-faith standard in *Boone v. Kerr-McGee Industries, Inc.*<sup>48</sup> The court said,

Where discretion is lodged in one or two parties to a contract or a transaction, such discretion must, of course, be exercised in good faith. That simply means that what is done must be done honestly to effectuate the object and purpose the parties had in mind in providing for the exercise of such power.<sup>49</sup>

As with the duty owed to the non-executive by the executive, some courts have attempted to introduce a fiduciary-duty standard into the exercise of the pooling clause. In *Vela v. Pennzoil Producing Co.*, the court rejected the importation of a fiduciary standard into the exercise of the pooling power.<sup>50</sup> The court said,

Although it has been said that the lessee has a fiduciary obligation in the exercise of the pooling power, it is submitted that the lessee is not a fiduciary and that such a standard is entirely too strict. This is so because the lessee has not undertaken to manage and develop the property for the sole benefit of the lessor. The lessee has a substantial interest that must be taken into account, and it would not be required to subordinate its own interest to the interest of the lessor. Since its interests are frequently in conflict with those of its lessor, it must exercise its power in good faith, taking into account the interest of both the lessor and lessee.<sup>51</sup>

One of the cases in which the court has used the "fiduciary" standard to govern the exercise of the pooling power is *Expando Production Co. v. Marshall*.<sup>52</sup> The *Expando Production* court clearly borrowed language from the executive rights cases dealing with the duty of "utmost good faith" and illustrated the difficulty of applying a true fiduciary standard.<sup>53</sup> In *Expando Production*, the lessee exercised its pooling power a second time to add a 1.92-acre tract to an already existing 10.1-acre pooled unit many years after the original unit was

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48. *Boone v. Kerr-McGee Indus., Inc.*, 217 F.2d 63 (10th Cir. 1954).

49. *Id.* at 65.

50. *Vela v. Pennzoil Producing Co.*, 723 S.W.2d 199, 206 (Tex. App.—San Antonio 1986, writ ref'd n.r.e.) (citing 3 EUGENE KUNTZ, LAW OF OIL AND GAS § 48.3, at 218 (1967)).

51. *Id.* For other statements adopting the "good faith" standard, see *Elliott v. Davis*, 553 S.W.2d 223, 226 (Tex. Civ. App.—Amarillo 1977, writ ref'd n.r.e.).

52. *Expando Prod. Co. v. Marshall*, 407 S.W.2d 254, 260 (Tex. Civ. App.—Fort Worth 1966, writ ref'd n.r.e.).

53. *Id.*



created.<sup>54</sup> While concluding that the pooling was in the best interests of both the lessor and lessee, the court noted that there were no real benefits for the lessor, whose pooled interest would be further diluted by the additional acreage being added to the pooled unit.<sup>55</sup> A true fiduciary standard would require the lessee to not further dilute the lessor's interest through the additional acreage. But having granted the lessee the power to pool, it is clear that, at most, there must be a balancing of the interests of the lessor and lessee and not a requirement that the lessee sacrifice its interest for the benefit of the lessor.

The issue of good or bad faith is typically a question of fact for the trier of fact.<sup>56</sup> There is no consistency in the cases that find good or bad faith, although there are a number of common factors that the courts tend to look at in making such judgments.<sup>57</sup> These factors include the following: inclusion of known or suspected barren acreage, proximity to the end of the primary term when the pooling was accomplished, presence of geological evidence supporting the pooling, whether the primary objective of the pooling was the maintenance of as many leases as possible, and whether there were alternative ways to pool that would not have injured the lessor's interest as much as the injury caused by the way the lessee actually exercised its pooling powers.<sup>58</sup>

One of the leading cases finding bad-faith pooling, *Amoco Production Co. v. Underwood*, found that the lessee had not acted in good faith because it was pooling merely to maintain various leases.<sup>59</sup> In *Underwood*, the lessee who had drilled a successful test well filed a declaration for a 668-acre unit and included 553 acres of the 643-acre Underwood lease and 135 acres from seven other leases.<sup>60</sup> The clear purpose of the pooled-unit designation was to hold all of the leases by production from the test well.<sup>61</sup> Because the entire Underwood lease could have supported the Railroad Commission drilling permit with a full allowable for the well, the court of appeals upheld the jury verdict, which had found bad faith.<sup>62</sup> The court was further influenced by the fact that the lessee had no plans to drill any additional wells on the 2,252 acres that were outside of

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54. *Id.* at 256.

55. *Id.* at 259-60.

56. See *Elliott*, 553 S.W.2d at 227; *Vela*, 723 S.W.2d at 205.

57. See KRAMER & MARTIN, LAW OF POOLING, *supra* note 1, § 8.06 (listing cases).

58. *Id.* (explaining the factors that multiple courts use).

59. *Amoco Prod. Co. v. Underwood*, 558 S.W.2d 509, 511-13 (Tex. Civ. App.—Eastland 1977, writ ref'd n.r.e.). A case with very similar facts that reached the same result is *Circle Dot Ranch, Inc. v. Sidwell Oil & Gas, Inc.*, 891 S.W.2d 342, 342-49 (Tex. App.—Amarillo 1994, writ denied). In *Hay v. Shell Oil Co.*, 986 S.W.2d 772, 776-79 (Tex. App.—Corpus Christi 1999, pet. denied), the court did not get to the merits of the bad-faith pooling claim because of the application of the statute of limitations. The factual assertion of bad faith was that a 244-acre lease was included in a 704-acre unit that included known barren acreage, as was evidenced by a successor lessee's shrinking of the pooled unit to 160 acres. *Id.* at 775.

60. *Amoco Prod. Co.*, 558 S.W.2d at 510.

61. *Id.* at 510-12.

62. *Id.* at 512-13.

the pooled unit but—due to the absence of any Pugh clauses—were being held by production from the pooled-unit well.<sup>63</sup>

In *Mission Resources, Inc. v. Garza Energy Trust*, the court upheld a jury verdict that had found bad-faith pooling.<sup>64</sup> The principal reason justifying the finding of bad faith was evidence that the pooled unit, which had been formed by the lessee, financially penalized the lessors to the benefit of the lessees and that there were other ways to pool the acreage without so penalizing the lessors' interests.<sup>65</sup> The court of appeals stated that the evidence showed that the lessee "did not adequately consider the financial interests of appellees in exercising its pooling power."<sup>66</sup> The Texas Supreme Court did not disturb the standard articulated by the court of appeals although, due to the admission of inflammatory but irrelevant documents, the court remanded the case back for a new trial.<sup>67</sup>

The good-faith standard is easy to state and hard to apply. This difficulty is inherent in any fact-based dispute in which the trier of fact has to resolve conflicting interpretations of fact, motive, or both in a particular decision with the benefit of hindsight. Absent the inclusion of known barren acreage, almost every other factual scenario will lead to a jury determination of whether or not the lessee acted in good faith and at least considered the interests of the lessor in deciding to pool and how to pool. Given the uncertainty about the effects of hydraulic fracturing on the target formation, there may be a lot of second guessing as to the proper boundaries of a pooled unit or a unitized area that might suggest that there be an appropriate mechanism for the revision of pooled units or unitized area boundaries after such information is garnered and processed. Likewise, creating a standard, square-pooled unit when the drainage from a horizontal wellbore is likely to be limited to twenty-five to fifty feet from that wellbore might run afoul of the traditional view that including known barren acreage is per se bad faith.

Up until 2008, it was the general opinion of many that, when a lease that had been committed to a pooled unit terminated, the mineral estate underlying the lease would no longer be committed to the pooled unit. There is clear language in *Texaco, Inc. v. Lettermann* that supports such a conclusion.<sup>68</sup> There are some contrary indications in *Ladd Petroleum Corp. v. Eagle Oil & Gas Co.*, but *Ladd* dealt with whether the termination of one of several leases from a pooled unit would terminate the unit as to the other non-terminated

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63. *Id.* at 512.

64. *Mission Res., Inc. v. Garza Energy Trust*, 166 S.W.3d 301, 316 (Tex. App.—Corpus Christi 2005), *rev'd on other grounds sub nom.* *Coastal Oil & Gas Corp. v. Garza Energy Trust*, 268 S.W.3d 1 (Tex. 2008).

65. *See id.*

66. *Id.*

67. *Coastal Oil & Gas Corp.*, 268 S.W.3d at 24.

68. *See Texaco, Inc. v. Lettermann*, 343 S.W.2d 726 (Tex. Civ. App.—Amarillo 1961, writ ref'd n.r.e.); *see also Trawick v. Castleberry*, 275 P.2d 292, 293-94 (Okla. 1953) (holding that the portion not communitized would no longer be extended to the lease of a pooled unit that has been terminated).

leases.<sup>69</sup> The *Ladd* issue was entirely different from the *Lettermann* issue as to whether the exercise of the pooling clause operated to pool the lessor's retained possibility of reverter.<sup>70</sup>

In 2008, in *Wagner & Brown, Ltd. v. Sheppard*,<sup>71</sup> the Texas Supreme Court essentially reversed *Lettermann* and adopted the view that, given the language contained in the leasehold pooling clause and the declaration of unit, the pooling is effective as to the former lessor's possibility of reverter and, thus, the pooling remains effective as to the unleased mineral interest that comes into existence upon the termination of the lease.<sup>72</sup> The facts in *Sheppard* are reasonably straightforward. In 1996 and 1997, Sheppard's lessee drilled two wells on the acreage leased from Sheppard and pooled that acreage with others to form a pooled unit.<sup>73</sup> Ms. Sheppard's lease had a royalty clause that contained a condition subsequent that, if royalties were not paid within the designated time period, the lease would terminate.<sup>74</sup> When Wagner & Brown took over as the pooled-unit operator, it discovered that its predecessors failed to make those royalty payments and requested that Ms. Sheppard execute a new lease.<sup>75</sup> After she refused to do so, Wagner & Brown treated Ms. Sheppard's interest as an unleased mineral interest owner, entitling her to an accounting, but did so on a unit basis and not a lease basis—even though Sheppard's interest covered the two drill sites.<sup>76</sup>

The court compared the language of the pooling clause, which limited the pooling power to “all or any part of the leased premises or interest therein with any other lands or interests,” with the language of the unit declaration, which stated that the lessees “hereby pool and combine said leases and the lands . . . into a single pooled unit.”<sup>77</sup> By bringing into the picture an instrument not executed by the lessor to define the scope of the pooling power, the court violated a basic canon of construction, namely that it should look within the

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69. *Ladd Petrol. Corp. v. Eagle Oil & Gas Co.*, 695 S.W.2d 99, 106-07 (Tex. App.—Fort Worth 1985, writ ref'd n.r.e.).

70. *Id.*

71. *Wagner & Brown, Ltd. v. Sheppard*, 282 S.W.3d 419 (2008). *Sheppard* is criticized at Laura H. Burney, *The Texas Supreme Court and Oil and Gas Jurisprudence: What Hath Wagner & Brown v. Sheppard Wrought?*, 5 TEX. J. OIL, GAS & ENERGY L. 219 (2009). See also SMITH & WEAVER, *supra* note 1, § 4.8[A], for a discussion in which the authors note that the court's use of the language of the unit declaration is inconsistent with *Tittizer v. Union Gas Corp.*, 171 S.W.3d 857 (Tex. 2005), which strictly construed the language of the pooling clause and limited the power to pool to the rights mentioned therein.

72. *Sheppard*, 282 S.W.3d at 424. The court attempted to distinguish Professor Martin's and my view that the pooling is effective only as long as the lease is in existence by suggesting that we rely too heavily on *Lettermann*. *Id.* at 424 n.19. As both of our treatises stated, and as we have further explained following *Sheppard*, we believe that it is the better position that the pooling clause, in the absence of express language to the contrary in the clause, does not operate to pool the possibility of reverter. See *id.*; KRAMER & MARTIN, LAW OF POOLING, *supra* note 1, § 15.04; MARTIN & KRAMER, OIL & GAS, *supra* note 1, § 931.2.

73. *Sheppard*, 282 S.W.3d at 421.

74. *Id.*

75. *Id.*

76. *Id.* at 421-22.

77. *Id.* at 422 (alteration in original) (internal quotation marks omitted).

“four corners” of the instrument—in this case, the lease—to determine the intent of the parties as written.<sup>78</sup> This is especially true when one of the two parties to the lease is not a party to the second instrument, which cannot expand the power granted by the lessor to the lessee in the lease.<sup>79</sup> As I have stated elsewhere,

The authors believe the Texas Supreme Court has misapplied common law contract and property principles. The court’s premise was that the lessor had expressly authorized the pooling of her possibility of reverter: “her lease allowed pooling of ‘all or any part of the leased premises or interest therein,’ and Sheppard’s reverter was certainly an interest in the leased premises . . .” First, the lessor’s possibility of reverter could not be part of the “leased premises” because she did not lease her possibility of reverter. Rather “leased premises” in a lease refers to what has been leased: the leased interests (e.g. oil and gas, coal, sulphur, helium etc.) and to the geographic and/or depth area. Second, an “interest therein” can only refer back to the “leased premises”; because Sheppards’ possibility of reverter was not leased, it cannot be an interest in the “leased premises.” A second obvious flaw in the court’s reasoning is its use of the lessee’s “Designation of Unit signed by the lessees . . . .”<sup>80</sup>

*Sheppard* appears to be the result of the Texas Supreme Court’s fealty to the written word, although, as noted above, the written word is not contained in the document that defines the scope of the pooling power. As such, careful drafting of the pooling clause by the lessor can prevent the *Sheppard* result by making it clear that the lessee only has the power to pool the fee simple determinable estate that has been conveyed and not the possibility of reverter that has been retained.

#### IV. EXPRESS RESTRICTIONS ON THE POOLING POWER

From the onset of the use of pooling clauses, unitization clauses, or both in leases, there have been provisions in such clauses that restrict the exercise of the power. One such limitation is a restriction on the purposes for which the

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78. See Bruce M. Kramer, *The Sisyphean Task of Interpreting Mineral Deeds and Leases: An Encyclopedia of Canons of Construction*, 24 TEX. TECH L. REV. 1, 14 (1993).

79. This point is well-made in SMITH & WEAVER, *supra* note 1, § 4.8[A], in which the authors state, To the extent that the court relies on language in the lessee’s declaration of pooling, which, unlike the pooling clause, specifically refers to pooling “land,” the decision is difficult to reconcile with *Tittizer v. Union Cas Corp.*, in which the court reiterated its past holding that a lessee’s authority to pool is controlled by the language of the pooling clause and indicated that a lessee’s authority cannot be enlarged by language in the unit declaration to which the lessor is not a party.

Similar criticism is provided by Professor Burney, *supra* note 71, at 241-42.

80. KRAMER & MARTIN, LAW OF POOLING, *supra* note 1, § 15.04, at 15-15 (footnote omitted) (first quote quoting *Sheppard*, 282 S.W.3d at 423).

pooling may be accomplished.<sup>81</sup> As noted above, lessees attempt to include in pooling clauses language that affords them the greatest discretion as to when and for what purposes they may pool.<sup>82</sup> Most pooling clauses that do refer to pooling in order to be in compliance with appropriate state spacing regulations use the disjunctive “or” so that a more general purpose, such as the promotion of the conservation of oil or gas, will expand the purposes for which the pooling power may be exercised.<sup>83</sup> But any clause that references state spacing rules may hinder a lessee’s ability to unitize rather than pool because unitization is not a function of spacing regulation.

A very common restriction on the pooling power is that it may only be exercised for gas wells or as to the production of gas.<sup>84</sup> In a recent case, the pooling provision restricted the lessee’s power to pool for any well that is “anticipated to be classified, or ultimately classified, as a ‘gas’ well by the governmental entity” unless all of the leased premises are included in the gas well unit or all of the leased premises are located in that gas well unit and another unit.<sup>85</sup> Obviously restrictions on including gas wells will restrict the ability of the lessee to pool for shale gas development.

In *Blocker v. Christie, Mitchell & Mitchell Co.*, the pooling clause limited pooling to gas wells only.<sup>86</sup> The lessee placed the plaintiff’s acreage into two units.<sup>87</sup> The wells were classified as gas wells but produced condensate, which was sold by the lessor and accounted to the plaintiffs on a pooled-unit basis.<sup>88</sup> They argued that, for condensate production, they were entitled to recover on a lease basis because the lessee did not have the power to pool oil or condensate.<sup>89</sup> The court disagreed, noting that “the condensate or distillate, under the record before us, was a constituent element of gas and under the pooling agreement payment therefor should be made proportionately to those with interest in the gas pool.”<sup>90</sup> The lessor’s claim would have seemingly prevented the pooling of the acreage because they were not gas wells but hybrid gas/oil wells.<sup>91</sup> Such an interpretation would wreak havoc with pooling clauses because many “gas” wells produce some quantity of natural gas liquids, which

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81. See, e.g., *Elliott v. Davis*, 553 S.W.2d 223, 226 (Tex. Civ. App.—Amarillo 1977, writ ref’d n.r.e.) (“There is, however, an implied requirement that the lessee exercise good faith in making the determination to pool.”).

82. See *supra* Part III.

83. See, e.g., *Buchanan v. Sinclair Oil & Gas Co.*, 218 F.2d 436, 441-42 (5th Cir. 1955) (holding that only the portion of the lease that was unitized is subject to being held by production of an off-site well).

84. MARTIN & KRAMER, OIL & GAS, *supra* note 1, § 669.2. For a case in which the gas-well-only restriction was critical to the termination of a lease and an overriding royalty interest, see *Sunac Petroleum Corp. v. Parkes*, 416 S.W.2d 798, 805 (Tex. 1967).

85. *HS Res., Inc. v. Wingate*, 327 F.3d 432, 436 (5th Cir. 2003) (applying Texas law).

86. *Blocker v. Christie, Mitchell & Mitchell Co.*, 340 S.W.2d 320, 320-22 (Tex. Civ. App.—Fort Worth 1960, writ ref’d).

87. *Id.*

88. *Id.* at 320-21.

89. *Id.* at 321.

90. *Id.* at 322.

91. *Id.*

can be removed from the natural gas stream through a variety of processes at different locations.

The issues of classifying wells as oil wells or gas wells or the specific language used in the pooling clause to limit pooling to “gas,” “gas rights,” or similar terms can create problems due to the fact that oil wells may produce natural gas and gas wells may produce natural gas liquids.<sup>92</sup> Whether a court gives a technical or regulatory meaning to these terms may well be dependent on whether it follows a strict or natural reading of the pooling clause.

In the Rocky Mountain Region where unitization clauses are much more frequent—as is the ownership of mineral resources by the federal or state government—it is often the case that there will be a reference in those clauses to the lessees receiving approval for such unitization from the appropriate governmental body, typically the Department of the Interior.<sup>93</sup> Because many states have procedures to have voluntary unit agreements approved, it will probably not be fatal for a lessee to seek such approval in order to comply with the pooling provision.<sup>94</sup> When substantial federal lands are not involved, the requirement for governmental approval appears to be unnecessary or redundant because the lessee is going to be under a good-faith duty to unitize the acreage. There is less likely to be a divergence of interests between the lessor and lessee in a unitization scenario than in a pooling scenario because the lessee will only unitize its acreage if it believes that its share of unitized production will be larger than production solely emanating from its lease or leases.

There is often a notice or recordation requirement before a pooled unit becomes effective.<sup>95</sup> The requirement may simply be that the lessee must notify the lessor in writing that a pooling of the leasehold acreage has been accomplished.<sup>96</sup> In many pooling clauses, a declaration of pooling may be required before the pooling becomes effective—hence the term “declared unit.”<sup>97</sup> When a lessee does not immediately comply with the condition precedent of filing a declaration of unit, the unit will not become effective until such time as the declaration is filed.<sup>98</sup> In *Tittizer v. Union Gas Corp.*, the Texas Supreme Court concluded that the effective date of the pooling is not when the lessee pooled the acreage and drilled a producing well but, rather, the date that the declaration of unit is filed so that the non-drillsite tract owners are only entitled to royalties from the filing date.<sup>99</sup> In one case, however, when the

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92. MARTIN & KRAMER, OIL & GAS, *supra* note 1, § 669.3.

93. *Id.* § 669.7.

94. *Id.* § 670.2.

95. *Id.* § 669.11.

96. *Buchanan v. Sinclair Oil & Gas Co.*, 218 F.2d 436, 493 n.3 (5th Cir. 1955).

97. *See, e.g., Union Gas Corp. v. Zion Lutheran Church of Mission Valley*, No. 13-01-740-CV, 2003 WL 22478927, at \*4 (Tex. App.—Corpus Christi Oct. 30, 2003, no pet.) (mem. op.).

98. *See id.*

99. *Tittizer v. Union Gas Corp.*, 171 S.W.3d 857, 861 (Tex. 2005); *see also Leach v. Brown*, 353 S.W.2d 920, 923 (Tex. Civ. App.—San Antonio 1962, writ ref'd n.r.e.); *Union Gas Corp. v. Gisler*, 129 S.W.3d 145, 150 (Tex. App.—Corpus Christi 2003, no pet.) (discussing a pooling clause providing in part, “Lessee shall file for record in the appropriate records of the county in which the leased premises are situated

declaration of pooling contained an error in the description of the stratigraphic interval that was producing, the court did not invalidate the pooling—even though the clause had a recordation requirement—because it found that, under the doctrine of quasi-estoppel, the lessor and its top lessee could not assert that the pooled unit was not in existence because they had accepted pooled unit royalties for many years.<sup>100</sup> This appears to be inconsistent with the dual views that the pooling power is to be narrowly construed and that the lessee must strictly comply with all conditions precedent in order to effectively pool the lessor's interest.

It has been a very common restriction on the exercise of the pooling power for there to be acreage limits, typically tied to whether an oil well or a gas well is drilled.<sup>101</sup> There may be “tolerance” acreage—typically 10%—so that the pooled-unit acreage may exceed the size of the applicable state-set spacing unit.<sup>102</sup> A common form of pooling clause used in Texas that specifies maximum acreage for pooled units but allows for larger units should the Railroad Commission “prescribe or permit” such units was given a very restrictive reading by the Texas Supreme Court in *Jones v. Killingsworth*.<sup>103</sup> The pooling clause provided in part,

Units pooled for oil hereunder shall not substantially exceed 40 acres each in area, and units pooled for gas hereunder shall not substantially exceed . . . 640 acres each plus a tolerance of 10% thereof, provided that should 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 by governmental regulations.<sup>104</sup>

The relevant Railroad Commission rules permitted 160-acre proration units but prescribed as proration units a minimum of 80 acres.<sup>105</sup> The lessee created a pooled unit of 160 acres.<sup>106</sup> The Texas Supreme Court took a narrow or restrictive view of the language of the pooling clause and presumed that the lessor did not intend to consent to the creation of a pooled unit for oil wells of indefinite size as may be permitted by Railroad Commission regulation.<sup>107</sup> The key language in the pooling clause is the last phrase from the clause cited

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an instrument describing and designating the pooled acreage as a pooled unit; and upon such recordation the unit shall be effective as to all parties” (emphasis omitted)). There were numerous cases filed due to the delay in the recordation of the declaration of pooling that are listed in MARTIN & KRAMER, OIL & GAS, *supra* note 1, § 669.11 n.17.1.

100. Cambridge Prod., Inc. v. Geodyne Nominee Corp., 292 S.W.3d 725, 732 (Tex. App.—Amarillo 2009, pet. denied).

101. MARTIN & KRAMER, OIL & GAS, *supra* note 1, § 669.10.

102. See *Jones v. Killingsworth*, 403 S.W.2d 325, 327 (Tex. 1965).

103. *Id.*

104. *Id.* (internal quotation marks omitted).

105. *Id.* at 327-28.

106. *Id.* at 326.

107. *Id.* at 328.

above, namely “with those prescribed by governmental regulations.”<sup>108</sup> The earlier language using the disjunctive “or” would seemingly allow the lessee to pool enough acreage so long as the Commission permitted or allowed such sized pooled units. Again, a simple drafting remedy can avoid the harsh result from the lessee’s perspective, and that is to add the words “or permitted” after “prescribed” in the last phrase.<sup>109</sup>

Due to the ever-changing way that state oil and gas conservation agencies deal with the reality of horizontal wells extending for several miles once the penetration point has been reached, tying the pooling power to agency rules or regulations is fraught with peril. Furthermore, in states that use field rules, spacing regulations may differ from field to field, and thus, the pooling power may be greater or lesser depending on the specific language in the field rules.<sup>110</sup> While reference to spacing or pooling rules may still be required, language needs to be included that can deal with super-size units such as will be allowed, for example, under the Louisiana Deep Well Act.<sup>111</sup>

There has always been lessor interest in limiting the pooling power or the effects of pooling through the use of a Pugh clause, a continuous development clause, or an acreage retention clause.<sup>112</sup> An example of the interplay of pooling, Pugh, and continuous development clauses is provided in *El Paso Production Oil & Gas v. Texas State Bank*.<sup>113</sup> There were two leases that originally covered about 1,707 acres.<sup>114</sup> One of the leases contained a habendum clause that allowed the lease to be extended beyond the three-year primary term if operations were conducted on the leasehold premises with no cessation of more than forty-five consecutive days.<sup>115</sup> There was also a pooling clause that gave the lessee the right to pool or unitize leasehold acreage with several different acreage limitations.<sup>116</sup> There was an 80-acre plus 10% tolerance limit, a 640-acre plus 10% tolerance limit, and a typewritten addendum that authorized 160-acre pooled units for the production of gas above a depth of 6,000 feet below the surface, 320-acre pooled units for the production of gas between 6,000 and 10,000 feet below the surface, and 640-acre pooled units for deeper production.<sup>117</sup> There was a Pugh clause and a continuous drilling operations clause that required the lessee to drill a new well every 100 days in order to hold the entire lease.<sup>118</sup> The continuous development clause also provided that if such development did not occur in the secondary

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108. *Id.* at 327 (emphasis omitted).

109. SMITH & WEAVER, *supra* note 1, at 4-132.

110. *See supra* note 100.

111. 2012 La. Acts 743 (amending LA. REV. STAT. ANN. §§ 30:5.1, 30:5.10A (1999)).

112. *See supra* note 101.

113. *El Paso Prod. Oil & Gas v. Tex. State Bank*, No. 04-05-00673-CV, 2007 WL 752209, at \*3 (Tex. App.—San Antonio Mar. 14, 2007, pet. denied) (mem. op.).

114. *Id.* at \*4.

115. *Id.* at \*2.

116. *Id.*

117. *Id.* at \*2-3.

118. *Id.* at \*3.



term, then the lease would terminate as to all lands except those “lands covered by this lease which are then allocated to a production unit or included in a pooled unit for a well capable of producing oil and/or gas in paying quantities.”<sup>119</sup>

Portions of the lease were included in four separate pooled units.<sup>120</sup> The declarations for these pooled units were horizon-specific and did not include all depths.<sup>121</sup> The lessee also voluntarily surrendered around 400 acres of the original leasehold estate.<sup>122</sup> The lessor asserted that, because of the pooling, Pugh, and continuous operations clauses, all depths had been released except for those depths set forth in the declarations of pooled units.<sup>123</sup> In effect, the lessor argued that the Pugh and continuous operations clauses operated to create a horizontal severance of the pooled-unit acreage.<sup>124</sup> Normally, when a lease covers all depths and there is a pooling that leads to production, the lease will be held as to all depths, not merely the horizon or producing formation.<sup>125</sup> The interpretational issue was whether the Pugh and continuous operations clauses made clear an intent to have not just a vertical severance into pooled and non-pooled acreage but also a horizontal severance.<sup>126</sup> Relying on *Friedrich v. Amoco Production Co.* to resolve the dispute, the court focused on the use of the term “land” in the pooling and Pugh clauses.<sup>127</sup> “Land” referred not to the producing horizon but to the surface acreage contained within the pooled unit.<sup>128</sup> To interpret those clauses as constituting a horizontal severance would mean that the parties had given the term “land” two different meanings, one relating to the habendum and rental clauses reflecting surface acreage and another relating to the pooling and Pugh clauses.<sup>129</sup> The court rejected such a view as being inconsistent with the canon of construction that gives terms within a written instrument the same meaning when repeated in different sections.<sup>130</sup>

Another way to achieve some of the same objectives that one can obtain through a Pugh clause is through the inclusion of an anti-dilution provision.

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119. *Id.* at \*5 (internal quotation marks omitted).

120. *Id.* at \*2.

121. *Id.*

122. *Id.*

123. *Id.* at \*3-4.

124. *Id.*

125. *Id.* at \*4-5 (citing *Scott v. Pure Oil Co.*, 194 F.2d 393, 395 (5th Cir. 1952)).

126. *See id.*

127. *See id.* at \*3-6 (citing *Friedrich v. Amoco Prod. Co.*, 698 S.W.2d 748 (Tex. App.—Corpus Christi 1985, writ ref’d n.r.e.)). The issue of horizontal severances in these cases is discussed in more depth at KRAMER & MARTIN, LAW OF POOLING, *supra* note 1, § 9.04.

128. *El Paso Prod. Oil & Gas*, 2007 WL 752209, at \*5-6.

129. *See id.*

130. *Id.* at \*6 (citing *Gonzalez v. Mission Am. Ins. Co.*, 795 S.W.2d 734, 736 (Tex. 1990)). Unfortunately, that canon of construction has not been widely used in the “two-grant” cases that plague Texas oil and gas jurisprudence. *See Kramer*, *supra* note 78, at 19-43.

Dean Smith and Professor Weaver described, as follows, the types of anti-dilution provisions that can arise:

Such clauses take a variety of forms. Some provide that the lessee must include all or a stated minimum percentage of the lease acreage within a pooled unit; others approach pooling from the other direction and stipulate that a minimum percentage of the pooled unit must be composed of leased acreage; still others prohibit pooling until all other leased acreage has been assigned to a drilling or spacing unit comprised only of leased acreage.<sup>131</sup>

Anti-dilution provisions, when combined with acreage limitations, tend not to function well in a horizontal well scenario.

The difficulty of not having a pooling or unitization clause that is written with horizontal wells in mind is illustrated in *Browning Oil Co. v. Luecke*.<sup>132</sup> The lease contained a pooling clause that had been amended several times after its execution because it contained various constraints on the pooling power.<sup>133</sup> One of the amendments to the pooling clause added the following anti-dilution provision: “Notwithstanding paragraph number four (4) hereof, if any pooled unit is created with respect to any well drilled on the land covered hereby, at least sixty percent (60%) of such pooled unit shall consist of the land covered hereby.”<sup>134</sup> Another provision allowed the lessor’s lands to be pooled—even if the lands constituted less than 60% of the pooled unit—when all of the lessor’s lands were included in the unit or such non-lessor lands were needed to comply with established field rules.<sup>135</sup>

The lessees wanted to drill two horizontal wells.<sup>136</sup> They unsuccessfully sought to amend the pooling clause to deal with the horizontally configured pooled units.<sup>137</sup> One of the horizontal wells crossed through seven tracts of land.<sup>138</sup> That well crossed through one of the three tracts of land subject to the lease.<sup>139</sup> The vertical wellbore and a portion of the horizontal wellbore were located on the lessor’s tract.<sup>140</sup> A second horizontal well crossed the other two tracts included within the lessor’s lease, although the vertical portion of the well

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131. SMITH & WEAVER, *supra* note 1, at 4-132. The following cases have one or more of these types of anti-dilution provisions: *HS Resources, Inc. v. Wingate*, 327 F.3d 432, 442 (5th Cir. 2003); *Sabre Oil & Gas Corp. v. Gibson*, 72 S.W.3d 812, 816 (Tex. App.—Eastland 2002, pet. denied); *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 637 (Tex. App.—Austin 2000, pet. denied).

132. *Luecke*, 38 S.W.3d at 636-39; see also Stephen Taylor Dennis, Comment, *Browning Oil Co. v. Luecke: Has Texas Illuminated a Dark Distinction Between Vertical and Horizontal Drilling*, 34 ST. MARY’S L.J. 215, 232-51 (2002).

133. *Browning*, 38 S.W.3d at 636-38.

134. *Id.* at 637 (internal quotation marks omitted).

135. *Id.*

136. *Id.* at 638.

137. *Id.*

138. *Id.*

139. *Id.*

140. *Id.*

was not physically located on the lessor's tracts.<sup>141</sup> The lessees essentially conceded that the two proposed pooled units did not comply with the anti-dilution provisions of the pooling clause.<sup>142</sup>

Having conceded that the horizontal pooled unit configurations violated the anti-dilution provision, the lessees tried to argue that a reasonable and prudent operator would not have pooled the acreage for the horizontal wells using the eighty-acre spacing patterns that the Railroad Commission had adopted.<sup>143</sup> The court easily rejected the assertion that an express limitation contained in the pooling clause might be avoided by claiming that following the express limitation would violate the reasonable and prudent operator standard.<sup>144</sup> The standard of conduct between the lessor and lessee is created and defined by the written language of the lease.<sup>145</sup> The fact that the lessee wanted to engage in activities that it believed would be reasonable and prudent cannot excuse the breach of the express language requiring that the lessor's interests not be diluted beyond an agreed-to percentage by the lessee's exercise of the pooling power.<sup>146</sup>

The trial court measured damages based on the traditional rules for the owner of a drillsite tract whose interests have been improperly pooled.<sup>147</sup> That measure of damages would be an undiluted royalty on all production coming through the wellbore that was located on the leased tract.<sup>148</sup> Because the second horizontal well crossed two of the three tracts under the lease, in theory, the lessor should have received a "double royalty" based on the illegal pooling.<sup>149</sup> In rejecting this recovery, the court articulated the reasons why a different damages rule should apply to wrongful pooling of royalty interests as applied to horizontal and not vertical wells.<sup>150</sup> It stated,

Horizontal wells can extend across several tracts of land in a linear configuration to accommodate the length of the horizontal drainhole. Consequently, all the tracts are not contiguous. Several tracts of land may separate the penetration point of the drainhole from the terminus point. And each of the tracts traversed by the horizontal drainhole is considered a drillsite tract, which likely includes underlying fractures that are being drained by the wellbore. Thus, each point along the drainhole is contributing

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141. *Id.* at 638-39.

142. *Id.* at 639.

143. *Id.* at 640.

144. *Id.* at 641.

145. *Id.* at 642.

146. *Id.*

147. *Id.* at 643.

148. *Id.* at 645. The wrongfully pooled tract is treated as never having been pooled so that the owner would be entitled, under the rule of capture, to 100% of the production or, in this case, 100% of the leasehold royalty. The general rule has been brought into question as it applies to vertical wells in *Wagner & Brown, Ltd. v. Sheppard*, 282 S.W.3d 419 (Tex. 2008).

149. *Browning*, 38 S.W.3d at 644.

150. *Id.* at 646.

to production from isolated fractures, and no one drillsite is naturally draining minerals from all of the penetrated tracts. Even though the rule of capture and other principles of oil and gas law would afford the Lueckes royalties on all production if a vertical well were drilled on their land without valid pooling, these principles have no application in the case of horizontal wells that contain multiple drillsites on tracts owned by multiple landowners.

Absent the ability to naturally drain neighboring tracts, the Lueckes are not entitled to production from other lessors' tracts unless there has been a cross-conveyance of property interests. Because the purported units were invalid, there has been no cross-conveyance of interests, and the Lueckes are not entitled to royalties on production from lands they do not own.<sup>151</sup>

While minimizing the damages awarded to a lessor whose interests have been invalidly pooled, the court clearly reemphasized the general principle that any restrictions on the power to pool granted in the lease to the lessor would be strictly enforced.<sup>152</sup>

Sometimes the drafters of anti-dilution provisions do not harmonize the anti-dilution language with other leasehold provisions. For example, in *Sabre Oil & Gas Corp. v. Gibson*, the lease contained the following anti-dilution provision:

[B]efore Lessee hereunder shall be allowed to pool or unitize any of the lands embraced by [the assignment of] this lease with other lands not owned by the Lessor herein Lessee shall designate full units from the lands embraced by [the assignment of] this lease first and in the event there is land in excess of a full unit remaining then same may be done in accordance with Paragraph "4" above.<sup>153</sup>

The lease also contained a clause allowing the lessee to partially assign the lease.<sup>154</sup> After such a partial assignment is accomplished under these types of lease provisions, the partial assignee includes all of the assigned leasehold acreage in a unit.<sup>155</sup> The acreage not assigned is not in any extant-pooled unit.<sup>156</sup> The court harmonized the language of the anti-dilution provision with the partial assignment provision by allowing a partial assignee to include all of the partially assigned acreage into a pooled unit.<sup>157</sup>

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151. *Id.*

152. *Id.*

153. *Sabre Oil & Gas Corp. v. Gibson*, 72 S.W.3d 812, 816 (Tex. App.—Eastland 2002, pet. denied) (internal quotation marks omitted).

154. *See id.* at 817.

155. *See id.*

156. *See id.*

157. *Id.* Professor Ed Horner believed that the court's harmonization of the two provisions was "both logical and sensible." *Id.* Because a community's lease is involved, Professor Horner believed that neither the lessor nor the lessee believed that the lease would be assigned to different parties on an area or geographic basis. *Id.*

A somewhat more direct conflict between the anti-dilution and other restrictions on the pooling power is reflected in *HS Resources, Inc. v. Wingate*.<sup>158</sup> While the pooling clause at issue in *Wingate* initially gave the lessee full discretion to pool and unitize the leasehold estate, it then restricted the power to pool a gas well unless all of the leasehold acreage was included and further restricted the size of units to 160 acres plus 10% tolerance.<sup>159</sup> On its face, the pooling clause first gave the lessee the power to pool but then took it away as to gas wells, which created a Sisyphean task of putting all of the leasehold acres into a pooled unit (728 acres total) while, at the same time, restricting the size of any pooled unit to 176 acres.<sup>160</sup> The 176-acre restriction, however, is limited to shallow wells, meaning those drilled to a depth of 10,000 feet or less, so that—as to deep gas wells, in theory—one could pool a gas well so long as the entire leasehold acreage was included.<sup>161</sup>

The existence of anti-dilution provisions will create disincentives for the voluntary pooling of horizontal well units and may encourage the use of the compulsory pooling powers given to the state conservation agencies in every major producing state except for Kansas. The general rule is that a lessee who goes through the compulsory pooling procedure is not constrained by any restrictions on its voluntary pooling power that may be contained in the leasehold-pooling clause.<sup>162</sup>

#### V. SOME SUGGESTIONS FOR THE FUTURE

One of the issues that arises with horizontal wells is whether the lease will be maintained by operations that take place not only off of the lease but also off of the acreage included in a pooled unit. It is not unusual when drilling a horizontal well that the surface location may be outside of the lease or the pooled unit. The pooled unit will only include acreage from whence the wellbore has entered the productive horizon. There are no cases on that specific issue in Texas, but in *Pioneer Natural Resources USA, Inc. v. W.L. Ranch, Inc.*, the court held that operations on the pooled unit were sufficient to hold the lease into the secondary term even though the drilling operations had not yet penetrated the lessor's acreage.<sup>163</sup> That is consistent with the general view that operations anywhere on the pooled unit will be treated as operations on the lease for purposes of satisfying any of the savings provisions of said lease.<sup>164</sup> A drafting solution to the issue of operations on non-pooled acreage

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158. *See HS Res., Inc. v. Wingate*, 327 F.3d 432, 442 (5th Cir. 2003).

159. *Id.* at 436.

160. *See id.*

161. *Id.*

162. *See Egeland v. Cont'l Res., Inc.*, 616 N.W.2d 861, 865 (N.D. 2000). *See generally* KRAMER & MARTIN, LAW OF POOLING, *supra* note 1, § 9.06 (regarding maintenance of lease acreage outside the unit).

163. *Pioneer Natural Res. USA, Inc. v. W.L. Ranch, Inc.*, 127 S.W.3d 900, 906 (Tex. App.—Corpus Christi 2004, pet. denied).

164. KRAMER & MARTIN, LAW OF POOLING, *supra* note 1, at ch. 20.

would seem appropriate. The objective would be to make sure that operations on non-pooled acreage that are intended to lead to a horizontal well being located within the boundaries of the pooled unit would be treated as operations on the leased premises.

The following are not “model” pooling clauses. They are provided merely to give the reader an opportunity to look at the language used to see if it would assist parties in the negotiation of a pooling clause. The first clause presents the pooling clause from the perspective of the lessor, and the latter clause presents the pooling clause from the perspective of the lessee.<sup>165</sup>

Lessee, on notice and approval of Lessor, with such approval not to be unreasonably withheld, 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, as to horizontal wells only, when it is necessary or advisable to do so in order to properly explore, or to develop and operate said leased premises, in compliance with the minimum spacing rules of the Railroad Commission of Texas or successor authority where the pooled size shall be the minimum acreage needed for the horizontal well drilled. Units pooled for oil hereunder shall not exceed the minimum size drilling or proration unit allowed by the Texas Railroad Commission (or a successor authority) for the lateral length drilled. After Lessor's approval, 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 and shall send a copy by certified mail, return receipt requested, to Lessor; and upon such recordation the unit shall be effective as to all parties hereto, their heirs, successors, and assigns. Lessee shall exercise its pooling option before commencing operations for or completing an oil or gas well on the leased premises. In the event of operations for drilling on or production of oil or gas from any part of a pooled unit, which includes all or a portion of the land covered by this lease, such operations shall be considered as operations for drilling on or production of oil or gas from land covered by this lease. SUBJECT TO THE TERMS OF THE CONTINUOUS-DEVELOPMENT CLAUSE. For the purpose of computing the royalties to which owners of royalties and payments out of production and each of them shall be entitled on production of oil and gas, or either of them, from the pooled unit, there shall be allocated to the land covered by this lease and included in said unit (or to each separate tract within the unit if this lease covers separate tracts within the unit) a pro rata portion of the oil and gas, or either of them, produced from the pooled unit after deducting that used for operations on the pooled unit. Such allocation shall be on an acreage basis—that is to say, there shall be allocated to the acreage covered by this lease and

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165. I am indebted to David Wallace of Sonora, Texas, for providing me some of the pooling clauses he favors as an attorney largely representing lessors and to Ben Sullivan of Energy Corporation of America for providing me a pooling clause he uses. Both gentlemen were speakers at the Third Annual Law of Shale Plays, sponsored by the Institute of Energy Law of the Center for American and International Law. I also wish to thank Kerry Kilbourne of the Kilbourne Law Firm for sharing some examples of production sharing agreements, which also appear in this Section.

included in the pooled unit (or to each separate tract within the unit if this lease covers separate tracts within the unit) that pro rata portion of the oil and gas, or either of them, produced from the pooled unit which the number of acres covered by this lease (or in each such separate tract) and included in the pooled unit bears to the total number of acres included in the pooled unit. Royalties hereunder shall be computed on the portion of such production, whether it be oil and gas, or either of them, so allocated to the land covered by this lease and included in the unit just as though such production were from such land. Lessee shall have the duty of utmost good faith in use of the limited pooling rights granted herein. Lessee agrees that a remedy Lessor may elect for failure to pool with utmost good faith is termination of the leases pooled in whole. Nothing in this pooling clause shall be interpreted to diminish Lessee obligations or Lessor's rights under the Continuous Development Program.

A pooling clause from a lessee perspective is as follows:

Lessee may pool or unitize any or all of the Leased Premises with other lands or interests to create one or more pools or units of any size and shape, not to exceed 1,280 acres (plus 10% tolerance); if larger pools or units are required by law, pools and units created hereunder may conform to such size. Pools and units may contain one or more wells. Any well or operations in a pool or unit shall be considered a well or operations on the Leased Premises except for royalties, which shall be allocated in the manner set forth below. A pool or unit may be created, changed, or cancelled by Lessee at any time (including after drilling) by filing a declaration-notice in the applicable county real property records. There shall be allocated to the portion of the Leased Premises in a pool or unit a fractional part of the production from the pool or unit in the proportion that the Leased Premises' acreage in the pool or unit bears to the total acreage in the pool or unit. For royalty purposes, the production so allocated shall be deemed the entire production from the portion of the Leased Premises included in the pool or unit. Lessee may use the entire Leased Premises for the operation of pools or units that contain a part of the Leased Premises, including to drill for, produce, transport, and remove Hydrocarbons from such pools and units.

In looking at any pooling or unitization clause, the drafter has to determine what is important from the client's perspective. For example, in the lessor-drafted clause the lessor is given the power to reject any proposed pooling, although consent may only be withheld if it is reasonable to do so. Some might argue that such a consent form is antithetical to the entire purpose of having a pooling clause in a lease. The notice-and-consent requirement, depending on the relationship of the lessor and lessee, may merely be a small hurdle to the lessee's ability to pool, or it may lead to litigation as to whether or not the consent is being withheld unreasonably. Both the lessor- and lessee-drafted pooling clauses use a surface-acreage allocation formula, which in horizontal

wells may not be the most accurate way of allocation. The problem with the use of either a different single factor, such as length of lateral or number of perforations, is that both the lessor and lessee may feel uncomfortable moving away from the historically tried and true measure, for pooled units at least, of using surface acreage as the sole factor.

The lessor-drafted clause is clearly only a pooling clause tied to the Railroad Commission spacing rules.<sup>166</sup> The lessee-drafted clause clearly authorizes a field-wide or partial field-wide unitization but is subject to a 1,280-acre limit.<sup>167</sup> While there may be larger spacing units than 1,280 acres, such as is now authorized in Louisiana, in my opinion, the restriction on size will discourage unitizations. The lessee-drafted clause also clarifies that, when there is a pooling or unitization, the surface easements that are typically lease-based will become unit-based.<sup>168</sup> It is not likely, however, that if there is a pre-pooling or pre-unitization severance of the surface estate, that the language in the lessee-drafted clause will be effective to increase the scope of the easement burdening that severed surface estate.

Pooling clauses should not be drafted in splendid ignorance of the remainder of the leasehold terms. Pugh clauses may or may not be included within the pooling clause provision. As shown by the lessor-drafted provision, the pooling provision should probably be tied into the continuous operations clause, if one is included in the lease, so that the impact of operations and activities on lands pooled with the leasehold acreage may count in the determination of whether the lessee is complying with the continuous obligations requirements.<sup>169</sup>

The clause provided below may answer some of the issues relating to whether the lessee may unitize, as opposed to pool, the leasehold acreage into a field-wide, or partial field-wide, unit:

[L]essee shall have the right to unitize, pool, or combine all or any part of the above described lands as to one or more of the formations thereunder with other lands in the same general area by entering into a cooperative or unit plan of development or operation approved by any governmental authority and, from time to time, with like approval, to modify, change or terminate any such plan or agreement and, in such event, the terms, conditions and provisions of this lease shall be deemed modified to conform to the terms, conditions, and provisions of such approved cooperative unit of development or operation . . . .<sup>170</sup>

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166. See *supra* text accompanying note 21.

167. See *infra* text accompanying note 170.

168. See *infra* text accompanying note 170.

169. See *supra* note 165 and accompanying text.

170. *Sotrana-Texas Corp. v. Mogen*, 551 F. Supp. 433, 434 (D.N.D. 1982) (first alteration in original) (internal quotation marks omitted).



This provision, while not created for horizontal drilling and hydraulic fracturing, has the potential for dealing with some of the issues that modern drilling and production techniques pose. It does have the requirement that the governmental authority must approve the “cooperative or unit plan of development,” which should be excised if the drafter is not in the Rocky Mountain Region.<sup>171</sup> Because almost all states, including Texas, have a procedure to approve a voluntary unit, the reference to governmental approval does not kill the unitization power—although it will require the lessee to go through the voluntary unitization approval process, which may be costly or time consuming depending upon whether or not there are parties who oppose the unitization.<sup>172</sup> Removing the governmental approval language would clearly give the lessee the power to unitize all or a portion of the field in order to maximize production.

As noted earlier, the predominant method by which pooled units allocate production and royalties is through a surface-acreage allocation formula.<sup>173</sup> Surface allocation, however, is rarely used in field-wide unitizations and only occasionally used in partial field-wide unitizations. It is common for unit agreements to have a multi-factor formula that is used to allocate production to the tracts that are committed to the unit.<sup>174</sup> Historically, the participation formula has included one or more of the following factors: “[1] The drive mechanism available in the field; [(2)] Well productivity; [(3)] Well density; [(4)] Effect of prorationing; [(5)] Acre feet of productive formation;” (6) Original oil or original gas in place; (7) Quality of information available relating to the unitized formation; (8) Extent of historical production; and (9) Current allowable formula.<sup>175</sup> Most of these factors are inappropriate for use in a partial unitization of a field that is being produced through horizontal wells. Yet, surface acreage is probably not a very good surrogate for providing a fair allocation of production and royalties from a horizontal well.

When leases provide that allocation shall be on a surface-acreage basis, unless the lessee wants to amend the lease or have the lessor sign a separate pooling agreement, surface acreage will have to suffice. That will make the decision about determining how much surface acreage to commit to a horizontal well-pooled unit very important. Does one merely allocate it based on the classic vertical well concentric circle assumption for drainage except in the case of a horizontal well? The vertical well assumption is probably not an accurate portrayal of the underground drainage pattern.

In response, lessors and lessees have begun to use production-sharing agreements (PSA) to come up with a more accurate and fair way to allocate

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171. *See id.*

172. *See supra* text accompanying note 170.

173. *See supra* Part II.

174. *See* KRAMER & MARTIN, LAW OF POOLING, *supra* note 1, § 17.02[5].

175. *Id.* (citing MARTIN & KRAMER, OIL & GAS, *supra* note 1, § 970.1).

production and royalties from horizontal well development.<sup>176</sup> A PSA has been defined as “an agreement between royalty, working, and other mineral interest owners with interests in multiple pooled units and/or unpooled leases in which the parties agree to a method for allocating production from horizontal wells traversing these lands.”<sup>177</sup> These types of PSAs are used in multi-unit situations, which would otherwise be amenable to a partial field-wide unitization in order to avoid some of the issues relating to the extant-pooled units. Of the PSAs that I have seen, almost all of them allocate production based on the length of the horizontal lateral on a particular tract in comparison to the total length of the horizontal lateral from the take point to the terminus of the lateral. I have seen some PSAs that measure what they call the “lateral line equivalent” as starting at the actual surface location of a well and ending at the terminus. To the extent that the non-horizontal portion of the horizontal well is not perpendicular to the earth, such an allocation formula would probably not be an accurate allocation of where the production is coming from.

In my opinion, allocation formulas for horizontal wells need to consider other factors than merely length of the lateral underneath a particular tract’s acreage, even though such a factor is probably just as valuable as the surface-acreage allocation formula for vertical wells. Other possible factors that could be included in the allocation formula include the number of perforations under a tract in relation to the total number of perforations in the well; the thickness of the shale over the length of the lateral; and the effectiveness of the perforations and hydraulic fracturing operations, which are not likely to be uniform over a mile or greater length of the lateral. This last factor, however, is only going to be known with any degree of certainty after the fracturing has been accomplished should the operator choose to do some post-fracing micro-seismic testing. It is extremely rare for pooled units to have a procedure for recalculating the participation formula, but such procedures are occasionally seen in unit agreements. Having such a procedure undoubtedly will involve substantial transaction costs because, after the recalculation, there may be net winners and losers from the earlier agreed-on formula.

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176. See MARTIN & KRAMER, OIL & GAS, *supra* note 1. The phrase “production sharing contract or agreement” has been used to describe a particular type of international petroleum agreement in which the contractor’s costs are recoverable out of production with a maximum limit on the amount of production that may be applied to cost recovery in any particular year. See *id.* at 827-28.

177. H. Phillip Whitworth & D. Davin McGinnis, *Square Pegs, Round Holes: The Application and Evolution of Traditional Legal and Regulatory Concepts for Horizontal Wells*, 7 TEX. J. OIL, GAS & ENERGY L. 177, 210 (2011-2012). The Railroad Commission has developed a model form PSA. See Form PSA-12, Production Sharing Agreement Code Sheet, R.R. Comm’n of Tex., available at <http://www.rrc.state.tx.us/forms/forms/og/pdf/formPSA-12.pdf>; see also Joe T. Sanders II, *Legal Issues Arising from Horizontal Drilling*, 29TH ANN. OIL & GAS & ENERGY RES. L. COURSE (State Bar of Tex. Oct. 2011).

## VI. CONCLUSIONS

I have always been a strong advocate that agreements should be enforced as written and that parties should take care in the drafting process to see that such agreements reflect their true intent. In order to achieve the full potential that horizontal-drilling and hydraulic-fracturing technologies hold for the United States, it is incumbent upon all of the stakeholders to draft instruments that take into account this new horizontal worldview. Pooling and unitization clauses, as well as pooling and unitization agreements, need to be redrafted in order to provide the maximum benefits for lessors, lessees, and unleased mineral interest owners. Thinking outside the box is required, as the old, tried-and-true paradigms really do not work well with horizontal drilling. Clients will be well served to go back to the drawing board and work on new language for pooling and unitization clauses that will be acceptable to all of the stakeholders.