

**FORCED POOLING:  
A NEW WAY OIL & GAS OPERATORS MAY BE ABLE TO AVOID EXPENSES<sup>1</sup>  
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With the widespread leasing in the Barnett Shale, many now understand that small tracts of land are usually “pooled” – that is, they are grouped together to form a drilling and production unit for a well. In Texas, pooling is usually established by voluntary agreement. However, to protect smaller landowners who might be unfairly excluded, the Texas Legislature enacted the Mineral Interest Pooling Act (“MIPA”), which in certain circumstances authorizes the Railroad Commission to force interests into a pool. Since MIPA was enacted forty years ago, successful applications to force pooling have been relatively rare. That may be changing, though, as developments in urban leasing areas have created an atmosphere where MIPA can morph into a powerful mechanism for operators that face checkerboard holdings due to mineral-owner holdouts or the recent widespread abandonment of leasing caused by plummeting gas prices.

*Economic Reasons to Pool*

To exploit their mineral interests, most small landowners will need to pool because their land is too small, or houses are too near, to support drilling. Operators also need to pool because it allows them to hold many leases by drilling a single well, and also allows the well to be placed far from where the reservoir will actually be tapped in order to comply with various spacing regulations. Pooling also permits operators to insulate themselves against potentially expensive applications to obtain exceptions to RRC rules governing well placement, or having to defend against expensive lawsuits alleging underground horizontal drilling trespassed their land or somehow breached other operator duties. Economic reasons notwithstanding, however, sometimes interest owners simply cannot reach agreement on pooling.

*Operation of the MIPA*

Although MIPA was originally designed to benefit small-tract owners, it has proved too expensive to efficiently protect those interests. However, MIPA contains no boundaries on the size of the applicant’s interest and so is easily accessible to operators or large interest owners. Although there are numerous technical requirements of a MIPA application, the most significant restriction is a party can apply *only* after failed voluntary pooling efforts that were “fair and reasonable.”

The MIPA statute provides that an offer to pool “on the same yardstick basis” as those owners that are already included within the pool is “fair and reasonable.” However, that yardstick basis must take into account what are called “reasonable risk penalties.” A “risk penalty” is essentially a surcharge on later-occurring profits when a party does not pay his proportionate share of the costs before the outcome of the well is known. In the Barnett Shale, however, because “dry holes” are nearly unheard of, anything more than a nominal risk penalty

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<sup>1</sup> A more in-depth work by Ms. Vaughn covering this topic is scheduled for publication in the TEXAS WESLEYAN LAW REVIEW in Fall 2009.

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will surely put the offer outside the “fair and reasonable” standard. In addition, MIPA dictates that a pooling offer can not be fair and reasonable if it gives the operator a right to unfair advantages such as a preferential right to purchase mineral interests, charges other than reasonable overhead, or precludes disputes over operation.

If the hurdle of a failed “fair and reasonable offer” is met and the RRC is persuaded to grant an application to force pool, the RRC has several options for apportioning ownership of production, distribution of royalties, and responsibility for drilling and completion costs. In all cases, however, the RRC’s mandate is to reach a fair result for all parties. There are several other technical requirements, but none precludes an operator from attempting to use MIPA, although most had never considered it until recently.

In late 2008, Finley Resources, Inc. is the first operator to successfully use MIPA after leasing efforts left it with incomplete holdings in an area near Fort Worth. In its application, Finley argued that if the unleased interests were not force-pooled, none of the interest owners would be able to develop their minerals because the sizes and locations of the non-pooled interests precluded efficient drill-pipe placement.

Accepting Finley’s arguments, the RRC found that forcing all leased and unleased parties into the proposed pool would benefit them all. To compensate the force-pooled parties, the RRC granted them the same royalty as those who had last voluntarily joined the pool. Although the RRC did not grant the involuntarily pooled owners a signing bonus, the RRC did grant a percentage of the profits generated after Finley recovers its drilling expenses. While not as lucrative up-front as a bonus, it is possible (if actual production is large enough) that the involuntarily pooled owners may eventually receive more cash than those who voluntarily joined the pool.

Either way, from the operator’s perspective, using MIPA may provide a cost-effective alternative vehicle for development in urban areas when leasing activities are not completely satisfactory, and can help operators avoid the regulatory and litigation expenses associated with incomplete leasing and pooling. Indeed, several other operators have already filed or are planning to file similar applications. Thus, MIPA’s forced pooling may be an old dog that has learned a new trick.