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POOLING AND  
UNITIZATION IN TEXAS

Thomas K. Dougherty

## **POOLING AND UNITIZATION IN TEXAS**

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## POOLING AND UNITIZATION IN TEXAS

### I. TERMINOLOGY

Pooled Unit: A unit formed by the bringing together of separately owned interests under the provisions of pooling clauses of leases or of some special agreement.

Proration Unit: Refers to a designated acreage content, which can be one or more leases, filed with the Railroad Commission in order to obtain an allowable for an already-drilled well.

### II. THE RULE OF CAPTURE AND THE EVOLUTION OF POOLING

The rule of capture has been defined by the Texas Supreme Court in *Elliff v. Texon Drilling Co.*, 210 S.W.2d 558 (Tex., 1948) as follows:

The 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.

Therefore, said owner can appropriate the oil or gas that has flowed from adjacent lands without the consent of the owner of those lands, and without incurring liability to him for drainage. The non-liability is based upon the theory that after the drainage the title or property interest of the former owner is gone. Obviously, given this theory, the adjacent land owners have traditionally protected themselves by drilling offset wells that would intercept the oil or gas otherwise produced by the neighboring wells.

It is not difficult to ascertain the two major problems associated with the rule of capture and the traditional response:

- (a) It creates a substantial amount of over-drilling, which translates to inefficient draining of oil and gas from a pool;
- (b) By focusing on surface property lines, the rule encourages the dissipation of the reservoir's natural energy.

The State of Texas, slowly but surely, recognized these shortcomings involved in blindly following the rule of capture and thus, the conservation statutes,

implemented and enforced by the Texas Railroad Commission, began their steady, but inevitable, erosion of the rule.

The basic constitutionality of conservation was established in *Ohio Oil Company v. Indiana*, 177 U.S. 190 (U.S. Supreme Court, 1900). Without going into the details of this case, it suffices to say that private property rights of a mineral owner can be constitutionally limited for the purpose of conserving the resource for the public benefit.

One obvious way to harness the rule of capture, and the resulting over-drilling, is the ability to control the spacing and drilling of wells. The Oil and Gas Division of the Texas Railroad Commission is generally vested with the power and charged with the duty to administer oil and gas conservation statutes by adopting rules and entering orders to:

- (a) prevent the waste of oil and gas;
- (b) protect the correlative rights of the owners.

*Railroad Commission v. Shell Oil Co.*, 380 S.W.2d 556 (Tex. 1964).

The Commission's statewide well spacing rule is the famous Rule 37, adopted in 1919. It has been changed six times over the years with respect to minimum distances to lease lines and between wells on the same lease. The last change was in 1962 when the minimum distances of 467 feet and 1200 feet, respectively, were adopted. This rule governs all wells for which no special field rules have been adopted. (See exceptions in Commission Districts 7B and 9).

The Commission's statewide density rule is Rule 38, and this rule outlines the minimum acreage required for each well within a field in Texas. Rule 38 also gives guidelines for a second well to be drilled within a lease or drilling unit so that sufficient acreage can be committed to the second well under the acreage requirements of the Railroad Commission.

Rule 40 of the statewide rules allows inclusion of acreage under applicable field rules into a development or proration unit if a plat is filed along with a Form P-12. The purpose of the Operator in utilizing Rule 40 to form a development or proration unit is to add a sufficient number of tracts or leases together to form a unit and receive the maximum allowable possible for the well located thereon.

Rule 31 is the gas well allowable rule, Rule 42 is the oil discovery allowable rule, and Rule 45 is the oil allowable yardstick rule.

In some instances, the Railroad Commission can even "force pool" acreage (*Texas Mineral Interest Pooling Act, V.T.C.A. Natural Resources Code §102.001 et seq*).

The purpose of citing the above rules is to show the clear relationship between the conservation statutes and their implementation to the evolution of pooling and unitization as a method of complying therewith. This paper will focus on the problems associated with "voluntary" pooling and unitization.

### III. JUDICIAL POOLING, AKA EQUITABLE POOLING

A discussion of judicial pooling in Texas rests upon an understanding of the non-apportionment rule, as expressed in the case of *Japhet v. McRae*, 276 S.W.2d 669 (Tex. Comm. App. 1925). After leasing, the original lessor of a 15 acre tract subdivided his estate. Pursuant to this subdivision, A owned the North 5 acres, and B owned the South 10 acres. The lessee drilled two wells on the South 10 acres, and the owner of the North 5 acres sought to recover his proportionate share of the royalties. The Court concluded that the owner of the North 5 acres should receive nothing. The Court utilized a hypothetical situation to justify its conclusion by relating to a one million acre lease. The Court said it was absurd to believe that an owner of a royalty interest some 75 miles away from the well should be entitled to receive his proportionate share or that the owner of the well-site would intend to have his share diminished by forced sharing pursuant to the apportionment rule.

This rule leads us into a discussion of judicial pooling or equitable pooling. In *Muller v. Southerland*, 179 S.W.2d 801 (Tex.Civ.App., 1943, writ ref'd, WOM), a lease of a larger tract was followed by the conveyance of two 12 acre tracts. The Railroad Commission had imposed a spacing and allowable requirement of 20 acres in the field in which the tracts were located. A well was drilled on each of the 12 acre tracts, but the lessee used 8 acres of Muller's land for their drilling and proration unit to meet the 20 acre spacing requirement. The Mullers claimed a proportionate amount of the royalty (8/20) from the wells producing on each 20 acre proration unit, but not on the lands owned by them. They claimed that the effect of the Railroad Commission's spacing order was to pool all of the interest within the 20 acre unit utilized by the lessee. The Court followed the *Japhet* decision in its adoption of the non-apportionment rule, and held that the Railroad Commission could not by its rules convey property rights which would be the result should a sharing or apportionment of the royalties be judicially mandated.

#### **IV. THE ENTIRETY CLAUSE**

The entirety clause provides for a proportionate division of royalty if the leased land, either at the time of leasing or subsequently, is owned in severalty or in separate tracts. The inclusion of this clause will negate the common law non-apportionment rule, and if included in the lease litigated above would have mandated a different result.

#### **V. COMMUNITY LEASES**

It has long been the rule in Texas that when separately owned tracts of land are included by the owners, as lessors, in a single oil and gas lease, the separate tracts and all mineral and royalty interests within them are treated as pooled, on a surface acreage basis, for the duration of the lease as a matter of law, in the absence of an express provision to the contrary. *Southland Royalty Co. v. Humble Oil & Refining Co.*, 249 S.W.2d 914 (Tex. 1952); *Parker v. Parker*, 144 S.W.2d 303 (Tex. Civ. App. 1940, writ ref'd). Such a lease of separately owned tracts is commonly known as a community lease.

The community lease may be "de-communitized" by voluntary partition among all the parties to such a lease, so that each of them will acquire the entire fee interest in a segregated tract. *Garza v. DeMontalvo*, 217 S.W.2d 988 (Tex. 1949).

#### **VI. EXERCISE OF POOLING POWER**

The lessee has no power to pool the leased estate with other land unless the lessor has expressly authorized it to do so. Therefore, most pooling in Texas is accomplished through the exercise of the rights set out in the pooling clause in the oil and gas lease. Attached hereto as Exhibit "A" is a "standard" oil and gas lease utilized in the State of Texas. You will note that Paragraph Four of the lease contains the terms and provisions on which the lessee can pool the lease with other lands and leases in order to form a pooled unit. We have attached as Exhibit "B" a "standard" pooled unit evidencing how the authority is utilized by the lessee. It is critical to remember that the entity that owns the title must exercise the pooling clause.

In *Pampel Interest, Inc. v. Wall*, 797 S.W.2d 392 (Tex.App., 1990 NWH) the plaintiff/lessors granted a lease with the primary term of two years to Pampel that contained a pooling clause. On the day that the lease was to expire, Zeal Energy filed a Unit Declaration for the pooling of some of the lease acreage to form a 160

acre unit. The unit well had already been commenced, but the operations were not upon the lease tract. The plaintiff/lessors and their new lessee sought declaratory judgment from the Court that the Pampel lease had expired. Pampel, which was owned by the same person who owns Zeal, asserted that Zeal filed the Unit Declaration as agent for Pampel. The Court held the Unit Designation was void because it was filed by a stranger to the lease title.

## VII. EFFECTIVE DATE OF POOLING

The determination of the effective date of the pooling can be critical where matters of lease perpetuation and sharing of production are concerned. This problem was demonstrated in *Sauder v. Frye*, 613 S.W.2d 63 (Tex. Civ. App. 1981, no writ). In that case, the lease pooling clause provided that:

“...If lessee does create any such unit or units under the rights herein granted, the lessee shall execute in writing and record in the county or counties in which each such unit or units created hereunder may be located an instrument identifying and describing each such unit or units so created.”

The lessee commenced a well on a neighboring lease. A few days before the expiration of the primary term of the lease in question, the lessee executed a pooled unit including that lease in a unit with the well tract. The lessee did not record the unit designation until a few days after the expiration of the primary term. The well was completed as a gas well.

The Court held that the unit designation was not effective until it was filed for record in the county where the land was located. Since the primary term of the lease in question, covering the non-well tract, had come to an end before the unit designation was filed for record, there was no constructive drilling or production occurring with respect to that lease at the end of its primary term and, therefore, it had expired by its own terms.

## VIII. POOLING MORE THAN ONCE

In the absence of a clause to the contrary, may the lessee exercise the pooling power more than once? *Texaco, Inc. v. Letterman*, 343 S.W.2d 726 (Tex.Civ.App. 1961, writ ref'd n.r.e.) held that a lessee could again pool the lease under the pooling clause after the prior unit had terminated. In this case, a portion of the acreage covered by the lease was initially pooled within a unit upon which a dry hole was drilled. The lessees thereafter dissolved the unit and pooled a different portion of the same lease within a subsequent unit. The unit well was

located upon acreage covered by our lease. Later, the lessee pooled the remainder of the lease into a unit and drilled a well upon said unit which produced in paying quantities. The lessor asserted that the lessee could not take the lease out of the unit in the first instance and therefore the lessor must be paid on a lease basis, not a unit basis, for the well drilled on his acreage. The lessor additionally claimed that once the lessee had pooled the lease once, then subsequent attempts at pooling were invalid. The Texas Court held that the first unit, upon which the dry hole was drilled, had terminated as a matter of law. The Court held that for a pooled unit to exist, it must be made up of two or more leases which are in force and effect. Since all the other leases subject to the Unit Designation terminated of their own accord, the unit therefore could not survive.

Compare this case with *Ladd Petroleum Corp. v. Eagle Oil & Gas Co.*, 699 S.W.2d 99, (Tex. App., 1985, writ ref'd n.r.e.). Two pooled tracts were held by a common lessee with a producing well on one of the tracts. The lessee mistakenly released the non-drillsite lease, took another one, and pooled the new lease in the same unit. Under *Letterman*, the old unit would have terminated. However, under *Letterman*, the unit well had ceased to produce. Here, there was continuous production so the facts apparently are distinct enough to justify a different result. What if the lessor under the drillsite had alleged termination? He didn't.

## IX. SAVINGS CLAUSE

There has been a Texas case that also gave a restrictive reading to the pooling clause as to the time for its exercise in relation to a 60 day operations clause. *Humble Oil and Refining Company v. Kunkle*, 366 S.W.2d 236 (Tex.Civ.App. 1963, writ ref'd, n.r.e.). The lease had a five year primary term, a 60 day continuous drilling clause and a pooling clause. A well being drilled on the lease at the end of the primary term was completed as a dry hole after the end of the primary term. Fifty-six days after the dry hole, the lessee pooled the lease with other land on which there was a producing well. The lessor claimed the lease terminated. The Court agreed. The lease did not provide for pooling after the end of the primary term so it terminated by its own terms. The Court read the savings clause literally and because it did not state ". . . or on lands pooled therewith," they held that the exercise of the pooling rights were prohibited. Under modern day savings clauses, you can see that it does state ". . . or lands pooled therewith." I would say this case is probably a major reason for that.

## **X. RESTRICTIVE INTERPRETATION OF POOLING CLAUSE**

A line of cases in Texas has given a restrictive interpretation to the language contained in the pooling clause. In *Jones v. Killingsworth*, 403 S.W.2d 25 (Tex. 1966), the pooling clause provided for pooling limits of 40 acres for oil and 640 acres for gas, but further stated ". . . 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." The lessee pooled for oil on 160 acres. The Railroad Commission permitted the 160 acre proration units but prescribed a minimum for such units as 80 acres. The Texas Supreme Court held that the pooling thus violated the area limitation of the pooling clause. This case is also widely cited for the axiom that the pooling clause will be construed strictly against the lessee.

## **XI. GOOD FAITH POOLING**

Most allegations of bad faith pooling arise where the lessee has apparently drawn the boundaries of the pooled unit to perpetuate as many leases as possible rather than to accomplish a permissible pooling goal. The question is generally treated as a question of fact for a jury to determine. An example of this is the case of *Elliott v. Davis*, 553 S.W.2d 223 (Tex.Civ.App. 1977, writ ref'd n.r.e.) where the Court held that neither the lessee's pooling of the lease shortly before the end of the primary term nor the Railroad Commission's refusal to approve the acreage as a unit established bad faith of the lessee as a matter of law. Therefore, the question of what constitutes good faith is one of fact to be resolved by the fact finder.

An example of bad faith is *Amoco Production Company v. Underwood*, 558 S.W.2d 509 (Tex.Civ.App. 1977, writ ref'd n.r.e.). In this case, the lessee used the pooling clause to pool 553 acres of the drillsite lease with 135 acres of some seven other leases, thereby seeking to hold about 2,252 acres of leased land. Because the lease where the unit well was drilled contained 643 acres, it was unnecessary to pool with other acreage to have a full spacing unit and to receive the full allowable under the Railroad Commission's rules. At the time of trial, the lessee had no plans to drill further on the 2,253 acres sought to be held by the unit. The Court held (on a jury verdict which was affirmed) that this was not a good faith exercise of the pooling clause and set the pooling aside.



The evidence which could be submitted to a jury to establish good faith or bad faith is the following:

1. Obvious gerrymandering of unit boundaries;
2. Express statements that they have been drawn to maintain leases;
3. Pooling an un-drilled tract just before the end of the primary term;
4. Testimony that the lessee did not consider geological factors in forming the unit;
5. The absence of plans for additional development;
6. The exclusion of productive acreage located near the well;
7. The inclusion of unproductive acreage or of acreage which is probably not within the well's drainage pattern; and,
8. Rejection of the unit by the Railroad Commission.

On the other hand, of course, the lessee will testify with right hand upraised and solemn looks of truthfulness that the purpose of that unit was to prevent waste and promote conservation of hydrocarbons and that the inclusion of 47 tracts into a unit shaped like Idaho was merely a coincidence.

## **XII. CHANGING THE SIZE OF AN EXISTING POOLED UNIT**

The cases and treatises have generally stated that the pooling authority granted in a lease is strictly construed, and only such authority as is specifically granted may be exercised by the Lessee. *Grimes v. La Gloria Corp.*, 251 S.W.2d 755 (Tex. Civ. App. 1952, no writ); *Jones v. Killingsworth*, supra; *Oil and Gas Law*, Williams & Meyers, Sections 980.4, 980.5; *Pooling and Unitization*, Raymond M. Meyers (1967) Sections 3.02 and 14.07; *Voluntary Pooling and Unitization*, Leo Hoffman (1954), Page 125, et seq.

The more recent case of *Expando Production Co. v. Marshall*, 407 S.W.2d 254 (Tex. Civ. App. 1966, n.r.e.) holds, in effect, that absent anything in the lease pooling provisions preventing enlargement, and if the enlargement is not inconsistent with governmental regulations, such pooled unit may be enlarged only by the lessee, acting in the utmost good faith and, indeed, the lessee may be

required to do so for the protection of the royalty owners. While this approach is far more preferable, *Expando* could be considered an anomaly since it stands virtually alone on these points.

I am satisfied that a persuasive argument can be advanced for either position, and because of the dearth of authority on the specific point, the issue cannot be clearly and unequivocally decided by the existing authority.

### **XIII. THE PUGH CLAUSE OR FREESTONE RIDER**

It has historically been held that pooling only a portion of the lease, however small, within the unit preserves and perpetuates the entire lease. The only recourse of a lessor in this situation is the implied covenant of reasonable development. The results of suing under this covenant have not historically been kind to the lessor. Out of this gridlock grew the Pugh Clause, or the Freestone Rider, and for our purposes that clause will be defined as a lease clause, the purpose of which is to divide or segregate the lease into separately maintained parts when a portion of the lease is included in a unit. We have attached as Exhibit "C" a "standard" freestone rider.

Generally speaking, Freestone Riders do not apply to tract wells even if they are declared as a pooled unit if no other leases or lands are actually pooled within said unit. *Mathis v. Texas International Petroleum Corp.*, 627 F.Supp. 759 (W.D. Tex. 1986). You must always say generally, because there seem to be as many Freestone Riders around as there are stars in the sky.

The following clause was litigated in *SMK Energy Corp. v. Westchester Gas Company*, 705 S.W.2d 174 (Tex.App. 1985, writ ref'd n.r.e.).

"Notwithstanding any provisions in this lease to the contrary, it is understood and agreed that this lease shall not (repeat not) extend beyond the primary term as to any part of the acreage described therein, excepting that part of the acreage which is then (at the end of the primary term) pooled or unitized for drilling, reworking operations, or production of oil and/or gas from such a unit or units then (at the end of the primary term) formed by LESSEE; and, as to that part of the acreage included within the boundaries of a unit or units so formed, such lease shall be perpetuated and continued only so long after the expiration of the primary term as production, drilling or reworking operation are continuously conducted thereon without interruption or cessation of more than ninety (90) days."

SMK acquired a lease covering 203 acres which contained the above clause. Within the primary term they drilled and completed a producing well and committed 40 acres of the lease to the proration unit surrounding the well. Westchester obtained a top lease of the acreage not within the 40 acre proration unit. This suit resulted. SMK argued that because no pooled unit was formed that the above clause was never triggered, thereby the entire lease was HBP. The Court held that the above rider was not a Pugh Clause, did not refer to the pooling provisions of the printed lease, and was in no way conditioned upon the exercise of the pooling rights granted by Paragraph 4 in said lease. The Court left open the question of what would have happened if Westchester had asserted a claim to the 40 acres committed to the well itself, but did hold that the remaining 163 acres were not "pooled or unitized" as provided in the rider at the end of the primary term.

Does a Freestone Rider result only in a vertical severance or is the severance both vertical and horizontal? In *Frederick v. Amoco Production Company*, 698 S.W.2d 748 (Tex.App. 1985, writ ref'd n.r.e.), the Freestone Rider was:

"In the event a portion or portions of the land herein leased is pooled or unitized with other land so as to form a pooled unit or units, operations on, completion of a well upon, or production from such unit or units will not maintain this lease in force as to the land not included in such unit or units. The lease may be maintained in force as to any land covered hereby and not included in such unit or units in any manner provided for herein; provided that if it be by rental payments, rentals shall be reduced in proportion to the number of acres covered hereby and included in such unit or units. If at or after the end of the primary term, this lease is being maintained as to a part of the lands by operations on, completion of a well upon, or production from a pooled unit or units embracing lands covered hereby and other land, and if at such time there be land covered hereby which is not situated in such unit or units and as to which the lease is not being maintained by operations, completion of a well, or production, Lessee shall have the right to maintain the lease as to such land by rental payments exactly as if it were during the primary term, provided that this lease may not be so maintained in force by rental payments more than three (3) years beyond the end of the primary term."

The facts of the case are relatively simple. Two adjoining leases, one covering 200 acres and the other covering 120 acres, were pooled to form a 320 acre unit as to rights from the surface to 1,298 feet. A gas well was then drilled

and shut-in gas royalty timely paid. The controversy centered upon the rights below 1,298 feet in the 320 acres. The lessors argued that the Freestone Rider, when read in conjunction with the unit, effectuated a termination as to all of those deep rights in the 320 acres. The Court of Appeals found that if the parties had intended horizontal severance, then the lease clause in question would have so provided. The Court held that all rights and depths within the unit were maintained by production from the unit. Generally, in the case of the Freestone Rider referenced above, if the lessee had drilled a well upon the lease and not pooled any portion thereof with other lands and leases, all of the lease would still be maintained by production, even though all of the lands covered by said lease were not included within the proration unit filed with the Railroad Commission for allowable purposes. This is because the Freestone Rider itself states that the lease may be maintained as otherwise set forth therein. Some Freestone Riders do specifically include proration units within the ambit of their coverage and, in such an instance, the lands covered by said lease not within the proration unit would expire absent operations or other production from the remaining portions of said lease. Each Freestone Rider will stand on its own and should be read carefully. Never assume that they don't apply to proration units. If it is ambiguous, follow the guidelines of *Jones*, supra: pooling authority will be construed strictly.

The case of *Parten v. Cannon*, 829 S.W.2d 327 (Tex. Civ. App. 1992, writ denied) construed a lease containing the following provision (only partially reproduced):

"Lessee must within ninety (90) days after the end of the primary term of this lease as to the leased premises which is not pooled under the provisions of Paragraph 4 hereof, designate in writing and place same of record with the County Clerk in Madison County, Texas, a description of that part of the leased premises which shall be allotted to such well for production purposes,..." and

"...Production or operations on said allotted area by the Lessee shall maintain this lease in effect only with regard to the land within the described area. This lease shall terminate as to such part or parts of the leased land lying outside the allotted area..."

It is undisputed that the Partens never recorded a written designation allocating any portion of the lease to producing wells at the end of the primary term. However, it is also undisputed that five wells were producing in paying quantities as of the end of the primary term; and that six additional wells were completed between 1981 and October, 1986. The threshold question the Court considered

was whether the above provisions were a covenant or a condition. The Court essentially held the production and allotment provision was a condition, breach of which resulted in automatic termination of the leasehold estate upon the happening of the stipulated events. They held that the designation and filing provision was essentially a covenant, and that the lessees would have ten days to satisfy their obligations in accordance with Paragraph 9 of the lease. Therefore, no automatic termination of the lease resulted from a breach of that provision. The Court then partially remanded the case to the jury for determination of what acreage was lost because of the breach of the production and allotment provision.

#### XIV. THE CROSS-CONVEYANCE THEORY

Texas follows the "cross-conveyancing" theory when determining the relationship of parties to a pooling or unitization. *Veal v. Thomason*, 159 S.W.2d 472 (Tex., 1942). In this case, numerous owners of mineral estates and various tracts of land executed a community lease or joint lease to the Texas Company. The lease provided for an apportionment of royalties for production located anywhere within the boundaries of the community lease. Thomason questioned title to Tract 68 and sued Veal for the mineral title and the Texas Company for the working interest as to said Tract 68. The Court held that all of the lessors in the community lease were joint owners, or joint tenants, of all royalties reserved therein, the ownership being in proportion which the acreage of each lease bears to the total acreage of the unitized block. You may ask, what were the ramifications of this decision? The Court held that each party to the 6,000 acre community lease was a necessary party and gave Thomason time to serve all of them with process. You can imagine what he would have had to do. The Court's inference in this case that the royalty in the community lease was cross conveyed has been extended to include all parties to a pooling or unitization agreement. *Texaco, Inc. v. Letterman*, supra.

Further extensions have been made with regard to division orders, *Pan American Petroleum Corp. v. Vines*, 459 S.W.2d 911 (Tex.Civ.App. 1970, writ ref'd, n.r.e.). In this case, the owner of a royalty interest bought an action against the gas unit operator to construe the terms of the division order that he had signed. All of the other royalty owners within the unit had signed an identical division order. The lessee argued that the non-joined parties who executed these division orders were indispensable parties. The Court concluded that a construction of the division order would in reality be a construction of all the other division orders, and therefore the non-joined parties were indispensable. The first Texas case extending the cross-conveyance doctrine to a pooling agreement was *Miles v. Amaretta Petroleum Corp.*, 241 S.W.2d 822 (Tex.Civ.App. 1950, writ ref'd n.r.e.). However, the cross-

conveyancing theory has not been extended to joint operating agreements, *Atlantic Richfield Company v. Exxon Corp.*, 678 S.W.2d 944 (Tex. 1984). The Court of Appeals basically stated that the contracts in question did not evidence an intent to cross-convey the gas reserves.

## **XV. TERMINATION OF UNITS**

When does a unit terminate? Obviously, a unit agreement may expressly provide when a unit will cease to have effect. The parties can agree to terminate a pooling or unitization by dissolution so long as all who are affected by the pooling agree to such termination. We've already seen circumstances (*Letterman*) where they terminate by operation of law.

## **XVI. PROBLEMS OF UNSIGNED, NON-POOLED OR NON-UNITIZED TRACTS OR INTERESTS**

It is apparent that no unleased mineral owner or other non-executive interest owner can have their interest pooled or unitized without their express consent. The ramifications accruing to this basic doctrine are very distinct when applied to drillsite and non-drillsite tracts. In Texas, "if there is no production from the tract in question, the uncommitted royalty interest, in the absence of equitable considerations, receives nothing even though there is production elsewhere in the unit." *Superior Oil Company v. Roberts*, 398 S.W.2d 276 (Tex. 1966).

If working interest owners have voluntarily pooled their interests in a unit, can a lessee who was not offered the opportunity to pool, ratify the unit and thereafter be a participant in the unit well(s) without the consent of the other working interest owners? The case of *Fletcher v. Ricks Exploration*, 905 Fed 2nd 890 (5th Circuit, 1990) attempted to answer this question. In this case, Ricks, and several other lessees, filed a Unit Designation which pooled the royalty and working interest of those who either signed or ratified the agreement. The area within the designation included the 30 acre tract leased to Fletcher. Fletcher was never informed of the pooling agreement. After learning of the Unit Designation, Fletcher attempted to ratify the agreement. In the interim, however, the Railroad Commission had determined that the 30 acre tract leased to Fletcher was non-productive acreage. Proceeds from the Ricks well were distributed to all signatory parties, including those who owned interests in the remaining 1/2 minerals in the 30 acre tract. Fletcher argued that the filing of the Unit Designation and the signing of the pooling agreement was an offer for all mineral owners within the specified area to join. Therefore, his ratification was an acceptance of the offer. This circuit rejected this offer and acceptance theory. The Court basically held that Fletcher was not a co-

tenant under these facts. We question the accuracy of this analogy but we do agree with the result.

## **XVII. NON-PARTICIPATING ROYALTY OWNERS (NPRI)**

The non-participating royalty interest owner generally owns a non-cost bearing interest in gross production carved out of the mineral estate. Generally, they don't have the right to participate in the execution of oil, gas and mineral leases. The party who does own the right is called the executive holder. Obviously, the non-participating royalty interest owner is dependent upon the executive in the execution of the lease, especially when they own a percentage of the royalty provided for in the lease. The duty owed by the executive to the non-executive could be the basis of another seminar but generally they owe a duty of good faith and utmost fair dealing.

For our purposes, we are going to concentrate on the pooling of non-participating royalty interests. It is obvious in Texas that without the consent of the non-participating royalty interest owner, the owner of the executive right does not have the power to authorize the pooling of his interest. *Montgomery v. Rittersbacher*, 424 S.W.2d 210 (Tex. 1968). If there is just one tract on the lease, then the decision by the non-participating royalty owner is simple. If the well is located on that tract, then he is entitled to his share of the well. If the well is on another tract, and the non-participating royalty interest tract is pooled therewith, then he can ratify the lease and share in production on a unit basis. When the executive owner executes a lease covering separate tracts with different royalty ownership, the Courts have held that this basically amounts to an offer by the owner of the executive right to the lessee and the non-participating royalty interest owner to create a community lease and to pool or unitize all of the royalties in all of the tracts covered by the lease. The ratification of such a lease by the non-participating royalty interest owner enables the non-participating royalty interest owner to share in the production from a well located on a lease tract other than the non-participating royalty interest owner's tract, *Ruiz v. Martin*, 559 S.W.2d 839 (Tex. Civ. App., 1977, writ ref'd n.r.e.), and also from a well located on an outside tract pooled with a tract covered by the same lease which covers the non-participating royalty interest owner's tract. (See *Montgomery*, supra).

Even if the lease contains an "anti-entireties" clause, the Courts have allowed the non-drillsite non-participating royalty interest owner to ratify the lease and receive an allocable share of production based on the offer to pool theory. *London v. Merriman*, 756 S.W.2d 736 (Tex. Civ. App. 1988, writ den'd) and *Verble v. Coffman*, 680 S.W.2d 59 (Tex. Civ. App. 1984, no writ). The non-participating

royalty interest owner can wait until the well is successfully completed before deciding whether to ratify the lease, and obviously he can also refuse ratification. In one case, *MCZ, Inc. v. Triolo*, 708 S.W.2d 48 (Tex. Civ. App. 1986, writ ref'd n.r.e.), the non-participating royalty interest owner was allowed to ratify one pooled unit which included his interest in a non-drillsite tract and then later refused to ratify another unit which included his interest in a drillsite tract. I don't trust that case. A non-participating royalty interest owner does have to ratify within a reasonable time, or he will be estopped to claim the benefits of pooling. *Nugent v. Freeman*, 306 S.W.2d 167 (Tex. Civ. App. 1957, writ ref'd n.r.e.).

In most cases, the ratification will be effective on the date of execution, but in one case, *De Benavides v. Warren*, 674 S.W.2d 353, 360 (Tex. Civ. App. 1984, writ ref'd n.r.e.), a non-participating royalty interest owner ratified a lease, and it was deemed to be retroactive to the date of creation and designation of the unit. Again, the relationship of non-participating royalty interest to pooling could be a seminar in and of itself, and the above is merely a highlight of the most pertinent aspects of that relationship.

## XVIII. ESTOPPEL

What about estoppel to challenge improperly formed units? It has been held that acceptance by royalty owners of royalty payments from unit production with full knowledge that they were in payment for royalty from a unit well, and that the unit well included their land and other lands which had been unitized, constituted a ratification of the unit, and therefore said royalty owners were estopped to later challenge the validity of the unit. *Leopard v. Stanolind Oil and Gas Company*, 220 S.W.2d 259 (Tex.Civ.App. 1949, writ ref'd n.r.e.). Sometimes this case has been cited as standing for the proposition that a lessor who has executed a division order which clearly identifies his lands as being including in a pooled unit and accepts the benefit of that unit will be estopped to challenge the validity of the unit. As all of you know, however, the ability to rely upon division orders has been drastically eroded in other areas, and we certainly don't recommend blind faith in this regard.

Estoppel did not work in the case of *Hunt Oil Company v. Moore*, 656 S.W.2d 634 (Tex.Civ.App. 1983, writ ref'd n.r.e.). The lease in this case mandated a maximum of 40 acre oil units. The Railroad Commission prescribed 80 acre field rules but permitted 160 acre units. The lease, covering 92 acres, was pooled into two 160 acre units. Neither of the unit wells was located on the lease. The Court applied *Jones*, supra, to this case, and held that the lessee did not have the power to pool this lease into 160 acre units and the lease therefore terminated. The



lessee relied upon the following actions of the royalty owners as a ratification and estoppel defense:

1. Execution of separate division orders for each unit; and
2. Cashing of checks representing proceeds from each unit.

The Court held that because the actions occurred after the termination of the lease, the actions would have no effect on said lease. There were other procedural matters involved in the disposition of this case which may render it questionable for precedent value but the lesson here is not to rely upon estoppel unless all else fails.

## **XIX. HORIZONTAL WELLS**

The first thing to remember with regard to these up-and-coming wells is that every tract penetrated by the wellbore has many of the legal characteristics of the drillsite in a conventional vertical unit. That means that every tract which could be penetrated by that wellbore had better be examined in the same manner and on the same basis as your drillsite in a conventional vertical unit.

## **XX. UNIT SIZE**

Typical horizontal field rules base production allowable upon surface acreage and permit additional acreage per well for increased "horizontal displacement". A typical lease form, at least the one in front of you, will conform somewhat to a horizontal situation because of the "prescribed or permitted" language in the lease. However, if it's an older HBP form lease, remember the trap in *Jones*, supra, where "prescribed" was interpreted so as not to allow a unit of an optional larger size permitted under the applicable field rules.

What about the dilemma regarding production while drilling? Ideally, horizontal units should be pooled effective as of the time the bit enters the productive formation; however, the final unit configuration won't be known until horizontal drilling within the formation is completed. This problem should be addressed by drafting a pooling clause to make units effective as of the date of first production while allowing units to be reformed after completion of the well if the horizontal displacement differs from that anticipated. Where you've got to "make do" with a conventional pooling clause, one solution is to file a unit designation prior to the commencement of the horizontal phase of drilling and include a provision in the unit that the unit can be amended after completion of the well if the horizontal displacement differs substantially from that anticipated and such amendment will

relate back to the date of first production. I haven't seen this tested in a reported case other than discussed above with regard to vertical pooling, but it certainly beats not trying.

## **XXI. AMENDING OLD UNITS**

Let's say there is a vertical well and you feel like you can cut a window in the casing and then dig your well horizontally as discussed above. This presents a problem because the existing well is still producing and located on a pooled unit but a substantially larger pooled unit will be required for the horizontal re-entry. What's going to happen if you want to dissolve the existing unit and form a larger unit that will be required for a horizontal re-completion? This particular situation, to my knowledge, has not been litigated. You really don't have a drafting opportunity because you're dealing with a pre-existing lease, and the older the lease, the less flexibility the lessee is going to have. Probably the fail-safe approach is to get all royalty and mineral owners in the existing unit to either amend the lease with a new pooling clause containing horizontal latitude or obtain their signature on the horizontal unit itself.

## **XXII. ALLOCATION FORMULAS**

As noted above, it seems that these horizontal units are still utilizing the traditional surface acre tract allocation formula for distributing production. This is required in our pooling clause. If done properly, a clause in the lease could base allocation on the length of the borehole under tracts in the unit.

What happens if you do trespass and how do you determine how much production occurred from the trespassed tract? The general rule is that one who wrongfully permits the property of another to become so intermingled and confused with his own property so as to render it impossible as to identify the goods of each is under the burden of disclosing such facts as will ensure a fair division. *Humble Oil and Refining Company v. West*, 508 S.W.2d 812 (Tex. 1974), appeal on remand 543 S.W.2d 667 (Tex.Civ.App. 1976, cert. denied, 434 U.S. 875). If the co-mingling party fails or refuses to meet this burden, the combined property or its value will be awarded to the injured party. Stated another way, a lessee who willfully co-mingles oil from various properties will be held to a strict requirement of allocating the production of the various properties and upon failure to show a proper allocation, the lessee must account on the entire co-mingled production. If the evidence establishes a reasonably certain estimate, then it will be divided on that estimated basis. The more the evidence indicates that the co-mingling is not willful, then the more latitude is allowed the person responsible for co-mingling.

My brother, Bob, recently tried a case in Fayette County, Texas, regarding the establishment of a unit for a horizontal well. The trial Court determined that the lessees had violated the pooling provisions in the leases, rendering the pooled units invalid, and the jury awarded the lessors \$833,256, plus pre- and post- judgment interest and attorneys' fees. The Appellate Court has wisely remanded the case for a re-determination of damages. No. 03-98-00638-CV, *Browning Oil Company, Inc. and Marathon Oil Company v. Jimmie M. Luecke and Leona M. Luecke*, Texas Court of Appeals, Third District, Austin. The appellees have filed a motion for rehearing.

In discussing the proper amount of damages, the Appellate Court noted that the Lueckes had contracted for a share in royalties based on total production from their land (Court's emphasis). The jury charge in the trial Court, according to the opinion, allowed and perhaps encouraged the jury to award the Lueckes royalties on oil and gas produced from lands the Lueckes did not own.

Probably the most interesting aspect of this case involves the Appellate Court's recognition of the public benefit of horizontal drilling and its application to the proper quantum of damages. The Appellate Court stated:

"On the other hand, we recognize the immense benefits that have accompanied the advent of horizontal drilling, including the reduction of waste and the more efficient recovery of hydrocarbons. Draconian punitive damages for a lessee's failure to comply with applicable pooling provisions could result in the curtailment of horizontal drilling. We decline to apply legal principles appropriate to vertical wells that are so blatantly inappropriate to horizontal wells and would discourage the use of this promising technology. The better remedy is to allow the offended lessors to recover royalties as specified in the lease, compelling a determination of what production can be attributed to their tracts with reasonable probability. See *Ortiz Oil Co. v. Luttes*, 141 S.W.2d 1050, 1053 (Tex. Civ. App.—Texarkana 1940, writ dism'd by agr.) (fact that exact amount of oil produced cannot be precisely determined is no reason for denying recovery based on jury's approximation). The Lueckes are entitled to the royalties for which they contracted, no more and no less."

# OIL, GAS AND MINERAL LEASE

THIS AGREEMENT made this \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_, between \_\_\_\_\_

Lessor (whether one or more), whose address is: \_\_\_\_\_

and \_\_\_\_\_, Lessee, WITNESSETH:

1. Lessor in consideration of \_\_\_\_\_ Dollars

(\$ \_\_\_\_\_), in hand paid, of the royalties herein provided, and of the agreement of Lessee herein contained, hereby grants, leases and lets exclusively unto Lessee for the purpose of investigating, exploring, prospecting, drilling and mining for and producing oil, gas and all other minerals, conducting exploration, geologic and geophysical surveys by seismograph, core test, gravity and magnetic methods, injecting gas, water and other fluids, and air into subsurface strata, laying pipe lines, building roads, tanks, power stations, telephone lines and other structures thereon and on, over and across lands owned or claimed by Lessor adjacent and contiguous thereto, to produce, save, take care of, treat, transport and own said products, and housing its employees, the following described land in \_\_\_\_\_

County, Texas, to-wit: \_\_\_\_\_

## Exhibit "A"

This lease also covers and includes all land owned or claimed by Lessor adjacent or contiguous to the land particularly described above, whether the same be in said survey or surveys or in adjacent surveys, although not included within the boundaries of the land particularly described above.

2. This is a paid up lease and subject to the other provisions herein contained, this lease shall be for a term of \_\_\_\_\_ years from this date (called "primary term") and as long thereafter as oil, gas or other mineral is produced from said land or land with which said land is pooled thereunder.

3. As royalty, lessee covenants and agrees: (a) To deliver to the credit of lessor, in the pipe line to which lessee may connect its wells, the equal one-eighth part of all oil produced and saved by lessee from said land, or from time to time, at the option of lessee, to pay lessor the average posted market price of such one-eighth part of such oil at the wells as of the day it is run to the pipe line or storage tanks, lessor's interest, in either case, to bear one-eighth of the cost of treating oil to render it marketable pipe line oil; (b) to pay lessor for gas and casinghead gas produced from said land (1) when sold by lessee, one-eighth of the amount realized by lessee, computed at the mouth of the well, or (2) when used by lessee off said land or in the manufacture of gasoline or other products, one-eighth of the amount realized from the sale of gasoline or other products extracted therefrom and one-eighth of the amount realized from the sale of residue gas after deducting the amount used for plant fuel and/or compression; (c) To pay lessor on all other minerals mined and marketed or utilized by lessee from said land, one-tenth either in kind or value at the well or mine at lessee's election, except that on sulphur mined and marketed the royalty shall be one dollar (\$1.00) per long ton. If, at the expiration of the primary term or at any time or times thereafter, there is any well on said land or on lands with which said land or any portion thereof has been pooled, capable of producing oil or gas, and all such wells are shut-in, this lease shall, nevertheless, continue in force as though operations were being conducted on said land for so long as said wells are shut-in, and thereafter this lease may be continued in force as if no shut-in had occurred. Lessee covenants and agrees to use reasonable diligence to produce, utilize, or market the minerals capable of being produced from said wells, but in the exercise of such diligence, lessee shall not be obligated to install or furnish facilities other than well facilities and ordinary lease facilities of flow lines, separator, and lease tank, and shall not be required to settle labor trouble or to market gas upon terms unacceptable to lessee. If, at any time or times after the expiration of the primary term, all such wells are shut-in for a period of ninety consecutive days, and during such time there are no operations on said land, then at or before the expiration of said ninety day period, lessee shall pay or tender, by check or draft of lessee, as royalty, a sum equal to one dollar (\$1.00) for each acre of land then covered hereby. Lessee shall make like payments or tenders at or before the end of each anniversary of the expiration of said ninety day period if upon such anniversary this lease is being continued in force solely by reason of the provisions of this paragraph. Each such payment or tender shall be made to the parties who at the time of payment would be entitled to receive the royalties which would be paid under this lease if the wells were producing, and

may be deposited in the \_\_\_\_\_ Bank at \_\_\_\_\_

\_\_\_\_\_ or its successors, which shall continue as the depositories, regardless of changes in the ownership of shut-in royalty. If at any time that lessee pays or tenders shut-in royalty, two or more parties are, or claim to be, entitled to receive same, lessee may, in lieu of any other method of payment herein provided, pay or tender such shut-in royalty, in the manner above specified, either jointly to such parties or separately to each in accordance with their respective ownerships thereof, as lessee may elect. Any payment hereunder may be made by check or draft of lessee deposited in the mail or delivered to the party entitled to receive payment or to a depository bank provided for above on or before the last date for payment. Nothing herein shall impair lessee's right to release as provided in paragraph 5 hereof. In the event of assignment of this lease in whole or in part, liability for payment hereunder shall rest exclusively on the then owners of this lease, severally as to acreage owned by each.

4. Lessee, at its option, is hereby given the right and power to pool or combine the acreage covered by this lease or any portion thereof as to oil and gas, or either of them, with any other land covered by this lease, and/or with any other land, lease or leases in the immediate vicinity thereof to the extent hereinafter stipulated, when in Lessee's judgment it is necessary or advisable to do so in order properly to explore, or to develop and operate said leased premises in compliance with the spacing rules of the Railroad Commission of Texas, or other lawful authority, or when to do so would, in the judgment of Lessee, promote the conservation of oil and gas in and under and that may be produced from said premises. Units pooled for oil hereunder shall not substantially exceed 40 acres each in area, and units pooled for gas hereunder shall not substantially exceed in area 640 acres each plus a tolerance of ten percent (10%) thereof, provided that should governmental authority having jurisdiction prescribe or permit the creation of units larger than those specified, for the drilling or operation of a well at a regular location or for obtaining maximum allowable from any well to be drilled, drilling or already drilled, units thereafter created may conform substantially in size with those prescribed or permitted by governmental regulations. Lessee under the provisions hereof may pool or combine acreage covered by this lease or any portion thereof as above provided as to oil in any one or more strata and as to gas in any one or more strata. The units formed by pooling as to any stratum or strata need not conform in size or area with the unit or units into which the lease is pooled or combined as to any other stratum or strata, and oil units need not conform as to area with gas units. The pooling in one or more instances shall not exhaust the rights of the Lessee hereunder to pool this lease or portions thereof into other units. Lessee shall file for record in the appropriate records of the county in which the leased premises are situated an instrument describing and designating the pooled acreage as a pooled unit; and upon such recordation the unit shall be effective as to all parties hereto, their heirs, successors, and assigns, irrespective of whether or not the unit is likewise effective as to all other owners of surface, mineral, royalty, or other rights in land included in such unit. Lessee may at its election exercise its pooling option before or after commencing operations for or completing an oil or gas well on the leased premises, and the pooled unit may include, but it is not required to include, land or leases upon which a well capable of producing oil or gas in paying quantities has theretofore been completed or upon which operations for the drilling of a well for oil or gas have theretofore been commenced. In the event of operations for drilling 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, regardless of whether such operations for drilling were commenced or such production was secured before or after the execution of this instrument or the instrument designating the pooled unit, such operations shall be considered as operations for drilling or production of oil or gas from land covered by this lease whether or not the well or wells be located on the premises covered by this lease and in such event operations for drilling shall be deemed to have been commenced on said land within the meaning of paragraph 3 of this lease; and the entire acreage constituting such unit or units, as to oil and gas, or either of them, as herein provided, shall be treated for all purposes, except the payment of royalties on production from the pooled unit, as if the same were included in this lease. For the purpose of computing the royalties to which owners of royalties 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 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 surface acres covered by this lease (or in each such separate tract) and included in the pooled unit bears to the total number of surface 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. The production from an oil well will be considered as production from the lease or oil pooled unit from which it is producing and not as production from a gas pooled unit; and production from a gas well will be considered as production from the lease or gas pooled unit from which it is producing and not from an oil pooled unit. The formation of any unit hereunder shall not have the effect of changing the ownership of any shut-in production royalty which may become payable under this lease. If this lease now or hereafter covers separate tracts, no pooling or unitization of royalty interest as between any such separate tracts is intended or shall be implied or result merely from the inclusion of such separate tracts within this lease but Lessee shall nevertheless have the right to pool as provided above with consequent allocation of production as above provided. As used in this paragraph 4, the words "separate tract" mean any tract with royalty ownership differing, now or hereafter, either as to parties or amounts, from that as to any other part of the leased premises.

5. If at the expiration of the primary term, oil, gas, or other mineral is not being produced on said land, or from land pooled therewith, but Lessee is then engaged in drilling or reworking operations thereon, or shall have completed a dry hole thereon within 60 days prior to the end of the primary term, the lease shall remain in force so long as operations on said well or for drilling or reworking of any additional well are prosecuted with no cessation of more than 60 consecutive days, and if they result in the production of oil, gas or other mineral, so long thereafter as oil, gas, or other mineral is produced from said land, or from land pooled therewith. If, after the expiration of the primary term of this lease and after oil, gas, or other mineral is produced from said land, or from land pooled therewith, the production thereof should cease from any cause, this lease shall not terminate if Lessee commences operations for drilling or reworking within 60 days after the cessation of such production, but shall remain in force and effect so long as such operations are prosecuted with no cessation of more than 60 consecutive days, and if they result in the production of oil, gas, or other mineral, so long thereafter as oil, gas, or other mineral is produced from said land, or from land pooled therewith. Any pooled unit designated by Lessee in accordance with the terms hereof, may be dissolved by Lessee by instrument filed for record in the appropriate records of the county in which the leased premises are situated at any time after the completion of a dry hole or the cessation of production on said unit. In the event a well or wells producing oil or gas in paying quantities should be brought in on adjacent land and within 330 feet of and draining the leased premises, or land pooled therewith, Lessee agrees to drill such offset well or wells as a reasonably prudent operator would drill under the same or similar circumstances. Lessee may at any time execute and deliver to Lessor or place of record a release or releases covering any portion or portions of the above described premises and thereby surrender this lease as to such portion or portions and be relieved of all obligations as to the acreage surrendered.

6. Lessee shall have the right at any time during or after the expiration of this lease to remove all property and fixtures placed by Lessee on said land, including the right to draw and remove all casing. When required by Lessor, Lessee will bury all pipe lines below ordinary plow depth, and no well shall be drilled within two hundred (200) feet of any residence or barn now on said land without Lessor's consent.

7. The rights of either party hereunder may be assigned in whole or in part, and the provisions hereof shall extend to their heirs, successors and assigns; but no change or division in ownership of the land, or royalties, however accomplished, shall operate to enlarge the obligations or diminish the rights of Lessee; and no change or division in such ownership shall be binding on Lessee until thirty (30) days after Lessee shall have been furnished by registered U.S. mail at Lessee's principal place of business with a certified copy of recorded instrument or instruments evidencing same. In the event of assignment hereof in whole or in part, liability for breach of any obligation hereunder shall rest exclusively upon the owner of this lease or of a portion thereof who commits such breach. If six or more parties become entitled to royalty hereunder, Lessee may withhold payment thereof unless and until furnished with a recordable instrument executed by all such parties designating an agent to receive payment for all.

8. The breach by Lessee of any obligation arising hereunder shall not work a forfeiture or termination of this lease nor cause a termination or reversion of the estate created hereby nor be grounds for cancellation hereof in whole or in part. No obligation reasonably to develop the leased premises shall arise during the primary term. Should oil, gas or other mineral in paying quantities be discovered on said premises, then after the expiration of the primary term, Lessee shall develop the acreage retained hereunder as a reasonably prudent operator, but in discharging this obligation it shall in no event be required to drill more than one well per forty (40) acres of the area retained hereunder and capable of producing oil in paying quantities and one well per 640 acres plus an acreage tolerance not to exceed 10% of 640 acres of the area retained hereunder and capable of producing gas or other mineral in paying quantities. If after the expiration of the primary term, Lessor considers that operations are not at any time being conducted in compliance with this lease, Lessor shall notify Lessee in writing of the facts relied upon as constituting a breach hereof, and Lessee, if in default, shall have sixty days after receipt of such notice in which to commence the compliance with the obligations imposed by virtue of this instrument.

9. Lessor hereby warrants and agrees to defend the title to said land and agrees that Lessee at its option may discharge any tax, mortgage or other lien upon said land, either in whole or in part, and in event Lessee does so, it shall be subrogated to such lien with right to enforce same and apply royalties accruing hereunder toward satisfying same. Without impairment of Lessee's rights under the warranty in event of failure of title, it is agreed that if this lease covers a less interest in the oil, gas, sulphur, or other minerals in all or any part of said land than the entire and undivided fee simple estate (whether Lessor's interest is herein specified or not), or no interest therein, then the royalties, and other monies accruing from any part as to which this lease covers less than such full interest, shall be paid only in the proportion which the interest therein, if any, covered by this lease, bears to the whole and undivided fee simple estate therein. All royalty interest covered by this lease (whether or not owned by Lessor) shall be paid out of the royalty herein provided. Should any one or more of the parties named above as Lessors fail to execute this lease, it shall nevertheless be binding upon the party or parties executing the same.

10. Should Lessee be prevented from complying with any express or implied covenant of this lease, from conducting drilling or reworking operations thereon or from producing oil or gas therefrom by reason of scarcity of or inability to obtain or to use equipment or material, or by operation of force majeure, and Federal or state law or any order, rule or regulation of governmental authority, then while so prevented, Lessee's obligation to comply with such covenant shall be suspended, and Lessee shall not be liable in damages for failure to comply therewith; and this lease shall be extended while and so long as Lessee is prevented by any such cause from conducting drilling or reworking operations on or from producing oil or gas from the lease premises; and the time while Lessee is so prevented shall not be counted against Lessee, anything in this lease to the contrary notwithstanding.

IN WITNESS WHEREOF, this instrument is executed on the date first above written.

\_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

STATE OF \_\_\_\_\_  
 COUNTY OF \_\_\_\_\_

**INDIVIDUAL ACKNOWLEDGMENT**

Before me, the undersigned authority, on this day personally appeared \_\_\_\_\_

known to me to be the person \_\_\_\_\_ whose name \_\_\_\_\_ is (are) subscribed to the foregoing instrument, and acknowledged to me that \_\_\_\_\_ executed the same as \_\_\_\_\_ free act and deed for the purposes and consideration therein expressed.

Given under my hand and seal of office this \_\_\_\_\_ day of \_\_\_\_\_, 19 \_\_\_\_\_

My Commission Expires \_\_\_\_\_

\_\_\_\_\_  
 Notary Public in and for the State of Texas

\_\_\_\_\_  
 Notary's Printed Name

STATE OF \_\_\_\_\_  
 COUNTY OF \_\_\_\_\_

**HUSBAND AND WIFE ACKNOWLEDGMENT**

Before me, the undersigned authority, on this day personally appeared \_\_\_\_\_

and \_\_\_\_\_ husband and wife, known to me to be the persons whose names are subscribed to the foregoing instrument, and acknowledged to me that they executed the same as their free act and deed for the purposes and consideration therein expressed.

Given under my hand and seal of office this \_\_\_\_\_ day of \_\_\_\_\_, 19 \_\_\_\_\_

My Commission Expires \_\_\_\_\_

\_\_\_\_\_  
 Notary Public in and for the State of Texas

\_\_\_\_\_  
 Notary's Printed Name

No. \_\_\_\_\_

**Oil, Gas and Mineral Lease**

FROM \_\_\_\_\_

TO \_\_\_\_\_

Dated \_\_\_\_\_, 19 \_\_\_\_\_

No. Acres \_\_\_\_\_

County, Texas \_\_\_\_\_

Term \_\_\_\_\_

This instrument was filed for record on the \_\_\_\_\_ day of \_\_\_\_\_, 19 \_\_\_\_\_, at \_\_\_\_\_ o'clock \_\_\_\_\_ M., and duly recorded in Book \_\_\_\_\_, Page \_\_\_\_\_ of the \_\_\_\_\_ records of this office.

By \_\_\_\_\_, Deputy County Clerk

When recorded return to \_\_\_\_\_

**Exhibit "B"**

**UNIT DESIGNATION**

**NO DRY HOLE GAS UNIT NO. 1**

**SMITH COUNTY, TEXAS**

**STATE OF TEXAS**

**§**

**KNOW ALL MEN BY THESE PRESENTS: THAT**

**§**

**COUNTY OF SMITH**

**§**

**WHEREAS, HOPING FOR EXPLORATION COMPANY** (hereinafter called "Lessee") is the present owner and holder of the oil, gas and mineral leases (hereinafter collectively referred to as "Said Leases"), identified and described on Exhibit "A" which is attached hereto and made a part hereof for all purposes, insofar as Said Leases cover the lands included within the hereinafter described unit; and

**WHEREAS**, each of Said Leases, as amended, provide that the Lessee shall have the right and power to designate, pool or combine, as to the gas rights therein and thereunder, the acreage covered thereby, or portions thereof, with other land, lease, or leases in the immediate vicinity thereof, in order to form a gas unit or units of the size and type hereinafter described, provided that the Lessee shall execute an instrument in writing identifying and describing such acreage; and

**WHEREAS**, in the judgment of Lessee it is necessary and advisable to designate Said Leases and to pool and combine Said Leases, insofar as they cover the lands included in the said unit, in order to properly develop and operate the premises for the production of gas, and in order to promote the conservation of gas in, under and that may be produced from said unitized premises;

**NOW, THEREFORE**, the Lessee, acting under and by virtue of the power and authority conferred and granted by the provisions of the oil, gas and mineral leases, as amended, described in said Exhibit "A", does hereby designate, pool and combine Said Leases into a unit designated as the No Dry Hole Gas Unit No. 1, containing 690.129 acres of land, more or less, being the land within the dashed outline on Plat marked Exhibit "B" and described by reference on Exhibit "C", said exhibits attached hereto and made a part hereof, for the purpose of developing and operating the lands and leases for the production, storage, processing, and

marketing of gas and gas rights, all as provided for in and authorized by Said Leases as amended. It is the intent to designate and pool all leases owned by Lessee covering said lands, regardless of whether said leases are listed on Exhibit "A".

This unit may be dissolved by the Lessee, its successors or assigns, by instrument filed for record in the appropriate records of Smith County, Texas, at any time after the cessation of production on said unit. Lessee reserves the right to amend this unit.

This instrument is signed by the Lessee on the date its signature is acknowledged, but it is understood and agreed that same shall be effective as of the date of first production.

**HOPING FOR EXPLORATION COMPANY**

By: \_\_\_\_\_  
Title: \_\_\_\_\_

**STATE OF TEXAS        §**

**COUNTY OF SMITH     §**

This instrument was acknowledged before me on this \_\_\_\_\_ day of \_\_\_\_\_, 2000, by \_\_\_\_\_ of HOPING FOR EXPLORATION COMPANY, on behalf of said corporation.

\_\_\_\_\_  
Notary Public, State of Texas  
Printed Name: \_\_\_\_\_  
Commission Expires: \_\_\_\_\_

***Exhibit "C"***  
**Freestone Rider**

In the event a portion or portions of the land described in this lease are pooled or unitized with other lands, lease or leases so as to form a pooled unit or units, drilling operations or production from the unitized premises shall maintain this lease only as to that portion of the leased premises within such unit or units, and, as to that portion of the leased premises not included in such unit or units, this lease may be maintained during and after the primary term by production of oil or gas therefrom or in any other manner provided for in this lease.