

## ARTICLE

# NEW OIL AND OLD LAWS: PROBLEMS IN ALLOCATION OF PRODUCTION TO OWNERS OF NON-PARTICIPATING ROYALTY INTERESTS IN THE ERA OF HORIZONTAL DRILLING

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## I. INTRODUCTION

Times are good in the Texas oil patch.<sup>1</sup> Although consumers might not agree when filling up their cars or heating their homes,<sup>2</sup> for the oil-man, the past couple of decades have seen a steady rise in the price of oil and related hydrocarbons,<sup>3</sup> along with a marked increase in onshore exploration and production activity.<sup>4</sup> As the size of the prize grows,<sup>5</sup> the Texas wildcatter (that most innovative of risk-prone entrepreneurs) and

1. See Rafael Sandrea, *Evaluating Production Potential of Mature US Oil, Gas Shale Plays*, OIL & GAS J., Dec. 3, 2012, at 58 (“Current production of crude oil is 6.3 million [barrels per day], the highest since 1997, and is expected to increase another 370,000 [barrels per day] in 2013.”).

2. See *Annual Energy Review*, U.S. ENERGY INFO. ADMIN. (Sept. 27, 2012), <http://www.eia.gov/totalenergy/data/annual/showtext.cfm?t=ptb0524> (tracking the rise of gasoline prices from an average of \$0.268 per gallon in 1949 to \$3.577 per gallon in 2011).

3. E.g., Robert Bejesky, *Geopolitics, Oil Law Reform, and Commodity Market Expectations*, 63 OKLA. L. REV. 193, 193–95 (2011) (discussing the fluctuating prices of oil).

4. See, e.g., John D. Furlow & John R. Hays, Jr., *Disclosure with Protection of Trade Secrets Comes to the Hydraulic Fracturing Revolution*, 7 TEX. J. OIL GAS & ENERGY L. 289, 298 (2011–2012) (tracing the increase in domestic energy production from shale gas and shale oil).

5. See *id.* at 299 (tracking the growth of domestic oil production from less than 5 million barrels a day in 2008 to a projected shale oil production of 6.7 million barrels every day by the year 2020).

major alike relentlessly push scientific boundaries to develop and implement drilling techniques that constantly change the definition of what is possible.<sup>6</sup>

The University of Texas at San Antonio estimated that in 2011 alone, oil and gas exploration and production activity accounted for a \$25 billion dollar impact on a twenty-county area in Texas overlying the Eagle Ford Shale formation.<sup>7</sup> On both a national and global level, the impact of the Eagle Ford and related shale plays in Texas is equally impressive.<sup>8</sup> The increase of hydrocarbon production from on-shore, domestic oil and gas plays—many of them either located within or managed remotely from Texas—have brought about a revolutionary re-orientation in global energy markets, decreasing the United States' energy dependence on foreign suppliers.<sup>9</sup>

At the heart of this energy revolution is a technological revolution; innovations in horizontal drilling techniques are fundamentally changing the way the industry drills for and produces hydrocarbons.<sup>10</sup> Hydrocarbon-bearing formations once previously thought uneconomical to explore, such as the Eagle Ford Shale in South Texas, are now profitable beyond the expectations of even the most optimistic commentators.<sup>11</sup> This evolution in the techniques operators use to drill for oil and gas is occurring at speeds that are, at times, beyond our legal framework's ability to keep up.<sup>12</sup> Simply put, as technology evolves, the

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6. See, e.g., *id.* at 296 (combining the slickwater hydraulic fracturing process with horizontal drilling to revolutionize the industry).

7. CTR. FOR CMTY. & BUS. RESEARCH, UNIV. OF TEX. AT SAN ANTONIO INST. FOR ECON. DEV., ECON. IMPACT OF THE EAGLE FORD SHALE 5 (May 2012), available at <http://eaglefordconsortium.org/wp-content/uploads/2012/05/utsamay2012.pdf>.

8. See John D. Furlow & John R. Hays, Jr., *Disclosure with Protection of Trade Secrets Comes to the Hydraulic Fracturing Revolution*, 7 TEX. J. OIL GAS & ENERGY L. 289, 299 (2011–2012) (referencing IHS Global Insight report finding a \$76 billion shale gas industry impact in 2010 alone).

9. See A.L. Parlow, *Rethinking a Twenty-First Century Model for Energy Development*, 87 N.D. L. REV. 691, 693 (2011) (“These [domestic] oil and gas plays are creating the potential for greater sources of domestic energy and energy from countries with greater political stability, thus creating the potential for greater energy resiliency for the United States, the world’s top oil consumer.”).

10. See *id.* at 694 (crediting new horizontal drilling techniques for a 71% increase in oil production in North Dakota’s Bakken Shale between June 2011 and June 2012).

11. See Rafael Sandrea, *Evaluating Production Potential of Mature US Oil, Gas and Shale Plays*, OIL & GAS J., Dec. 3, 2012, at 58 (“We can now access vast oil and gas resources that we have known to exist for decades but were impossible to recover because of their low permeabilities.”).

12. See H. Philip 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, 213 (2011–2012) (“The continued expansion of horizontal drilling will undoubtedly present new land and legal challenges for the oil and gas industry, its regulators, and the interest owners it affects to resolve.”).

legal community is left to increasingly apply old law to new concepts—frequently with frustrating and counterintuitive results.<sup>13</sup>

Oil and gas exploration and production is an old business in Texas.<sup>14</sup> Delayed by the outbreak of the Civil War, Lyne T. Barret finally spudded the first Oil Springs area well in September 1866, which he drilled to a total depth of 106 feet, marking the beginning of exploration in Texas.<sup>15</sup> Texas historians recall the accidental oil strike in the Corsicana Field in 1894;<sup>16</sup> schoolchildren recognize the name Spindletop and the story of its gusher in 1901;<sup>17</sup> and diligent oil and gas researchers may even be aware of the details of excavation activity that was underway in 1866 near Oil Springs in Nacogdoches County.<sup>18</sup>

From those humble beginnings, oil and gas exploration in Texas became not only a big business, but also an expensive business.<sup>19</sup> For example, the current estimated cost to drill and complete a single horizontal well in the Eagle Ford Shale is between \$7–10 million.<sup>20</sup> Unfortunately, fixed costs of drilling alone are just a part of what makes exploration an expensive venture.<sup>21</sup> On top of these significant capital outlays are those less-quantifiable, yet perhaps greater, potential expenses that spring from the persistent risks that accompany hydrocarbon development. These include dry holes<sup>22</sup> and structural integrity failures of the wellbore.<sup>23</sup> The

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13. *See id.* at 178 (arguing traditional legal and regulatory methods that worked for vertical drilling do not apply as effectively to horizontal wells).

14. *See An Informal History Compiled for Its Centennial*, R.R. COMM'N OF TEX. (last visited Apr. 9, 2013), <http://www.rrc.state.tx.us/about/history/centennial/centennial05.php> (dating the first attempt at oil drilling in Texas to shortly after the Civil War).

15. *Id.*

16. *See id.* (dubbing the Corsicana oil find the first major discovery in Texas).

17. *See id.* (attributing the Spindletop gusher to Anthony Lucas who recognized that the salt domes were trapping valuable reservoirs of oil).

18. Eugene M. Kim, *Texas Oil and Gas*, BUREAU OF ECON. GEOLOGY, at 3 (Aug. 2003), available at <http://www.beg.utexas.edu/mainweb/services/pdfs/giddings.pdf>.

19. *See id.* (estimating the economic impact of the oil industry on the Texas economy at more than \$105 billion and 691,993 jobs).

20. Jennifer Hiller, *Drillers Drawn to Rocks Around Eagle Ford, Too*, SAN ANTONIO EXPRESS NEWS (Nov. 4, 2012), [http://www.mysanantonio.com/news/local\\_news/article/Drillers-drawn-to-rocks-around-Eagle-Ford-too-4006628.php](http://www.mysanantonio.com/news/local_news/article/Drillers-drawn-to-rocks-around-Eagle-Ford-too-4006628.php).

21. *See* Daniel L. Berman, *Dry Hole, Drilling Operations, and 30 Day-60 Day Drilling Operation Clauses*, 38 TEX. L. REV. 270, 271 (1960) (“[T]he cost of drilling a well may often be more than the total amount of the delay rental payments . . .”) (footnote omitted).

22. “A dry hole is a well drilled to a depth at and below which there is no reasonable probability of discovering oil or gas.” *Id.* at 272–73.

23. “A ‘wellbore’ is defined as the hole in the ground made by a well.” Kurt M. Peterson, *Wellbores: Shedding Light on a Transactional Black Hole*, 48 ROCKY MTN. MIN. L. INST. § 13.03 (2002). Further, “Drilling a well, and thus creating a wellbore, is still the only method to test and produce potential hydrocarbon heavy formations.” *Id.*

weight of this risk increases significantly when utilizing new, and at times unproven, drilling methods.<sup>24</sup> While the oil and gas operator can exercise comparatively little control over the technical and scientific risks of innovative drilling techniques, a great deal of consideration is given to the more manageable political and legal risk exposure presented by operations in a given geographical area.<sup>25</sup>

As with any business, when faced with competing alternatives, operators generally prefer to pursue exploration in areas with more stable and predictable legal environments.<sup>26</sup> Stability and predictability enable firms to mitigate a portion of the risk inherent in operations, thus reducing costs.<sup>27</sup> For communities, states, and nations seeking to encourage potentially lucrative economic activity, it is incumbent upon them to establish and maintain a reasonable and consistent legal architecture to guide business entities in their operations.<sup>28</sup>

Such efforts have previously been made in Texas, but as technology advances, legal rules often become unclear in their application.<sup>29</sup> In an article on the general evolution of legal concepts applied to horizontal drilling, two leading experts stated that the “explosion in horizontal drilling activity is challenging the courts and the Railroad Commission of Texas (RRC) to apply and adapt traditional legal and regulatory concepts—

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24. See Richard Finger, *We're Headed To \$8 Natural Gas*, FORBES (July 22, 2012), <http://www.forbes.com/sites/richardfinger/2012/07/22/were-headed-to-8-00-natural-gas/> (estimating expenses incurred drilling a horizontal dry gas well between \$8.5 million and \$12 million, including up to 25% for mineral owner royalty payments, state severance taxes of 7.5% in Texas, ad valorem taxes of 2%, operating expenses between \$120,000 and \$160,000, gas cleaning costs, and pressure compressors).

25. See Ambrose O.O. Ekpu, *Environmental Impact of Oil on Water: A Comparative Overview of the Law and Policy in the United States and Nigeria*, 24 DENV. J. INT'L L. & POL'Y 55, 106 (1995) (“The regulatory agencies should be removed substantially from ministerial control under which they currently operate. They should be able to enact and enforce regulations without reference to a minister in order to minimize political influences and red tape.”).

26. See, e.g., *id.* at 80–81 (discussing difficulties facing oil companies drilling in a country where regulations are unclear and subject to change).

27. See Black Hills Exploration Production, *Hearing Before the Oil and Gas Conservation Comm'n of the State of Wyo.* (June 10, 2003) (attributing the explosive growth in horizontal well drilling permits in Texas in part to the state's progressive regulation of the practice) (on file with the *St. Mary's Law Journal*).

28. See *id.* (noting Texas was among the first states to create horizontal drilling regulations when it adopted Rule 86 in 1990).

29. See H. Philip 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, 182 (2011–2012) (“Until 1990, the RRC's rules . . . were drafted to regulate drilling and production from vertical or intentionally deviated directional wells. In many instances, these traditional rules cannot be neatly applied to horizontal wells.”) (footnote omitted).

developed over more than a century for *vertical* drilling and development—to horizontal wells.”<sup>30</sup>

The growing dominance of horizontal well development is undeniable.<sup>31</sup> Even though vertical well production remains the most commonly used method of hydrocarbon extraction in the state,<sup>32</sup> more than forty percent of all permitted wells in Texas in 2011 were planned horizontal completions.<sup>33</sup> In the Eagle Ford Shale alone, the growth in horizontal drilling permits increased from twenty-six in 2008 to a staggering 4,145 in 2012.<sup>34</sup> With this dramatic growth in the drilling of horizontal wells, legal practitioners, judges, and legislators must ensure that Texas oil and gas jurisprudence protects property rights in light of such technological progress.<sup>35</sup> A narrow, yet significant issue in need of immediate legal attention is the uncertain status of the non-consenting, non-participating royalty interest (NPRI) within a horizontally pooled unit.<sup>36</sup>

Part II of this Article addresses the history and fundamentals of pooling royalty interests in Texas. Part III focuses on the characteristics and powers of the NPRI and its relationship to other forms of mineral ownership, such as executive right holders and non-participating mineral interests. Part IV traces various judicial decisions that expanded NPRI

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30. *Id.* at 178.

31. *See, e.g., id.* (crediting continued refinement in drilling techniques for the boom in horizontal drilling in Texas).

32. *See, e.g., Directional and Horizontal Drilling*, NATURALGAS.ORG, [http://www.naturalgas.org/naturalgas/extraction\\_directional.asp](http://www.naturalgas.org/naturalgas/extraction_directional.asp) (last visited Apr. 9, 2013) (“Horizontal drilling now accounts for [five] to [eight] percent of active onshore wells in the U.S., and seems to be increasing every year.”).

33. H. Philip 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, 181 (2011–2012).

34. *Texas Eagle Ford Shale Drilling Permits Issued 2008 Through 2012*, R.R. COMM’N OF TEX. (Mar. 20, 2013), available at <http://www.rrc.state.tx.us/eagleford/EagleFordDrillingPermitsIssued.pdf>. For a more complete discussion of the growth of horizontal drilling, see H. Philip 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, 180–82 (2011–2012) (explaining the history and development of horizontal drilling in Texas).

35. *See* H. Philip 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, 213 (2011–2012) (“The proliferation of horizontal drilling over the past decade has challenged the courts, the RRC, and practitioners alike to adapt traditional legal and regulatory concepts to address the unique issues presented by horizontal wells.”).

36. *See* Christopher Kulander, *Big Money vs. Grand Designs: Revisiting the Executive Right to Lease Oil & Gas Interests*, 42 TEX. TECH L. REV. 33, 48 (2009) (“[U]nlike an interest in the mineral fee, an NPRI is ‘an interest in gross production of oil, gas, and other minerals carved out of the mineral fee estate as a free royalty.’”) (emphasis omitted).

powers to current levels. Part V addresses the Texas Legislature's attempt to fix this problem by proposing legislation aimed at curbing the expansive NPRI power and encouraging drilling. Part VI describes the problems associated with the current state of the law. Part VII delineates suggested methods for allocating production in the face of non-consenting NPRI owners in unpooled tracts. Part VIII centers on the ultimate problem of NPRI's within a horizontally pooled unit and provides real world examples dealing with NPRI refusal of pooling ratification.

## II. HORIZONTAL DRILLING AND POOLING

### A. *Horizontal Drilling*

Technological innovation in the form of horizontal drilling brought uncertainty to some of the underlying legal premises in the application of Texas real property law to the narrow field of oil and gas.<sup>37</sup> Before the established legal framework can provide adequate protection to mineral and royalty interest owners and producers—modification, or perhaps clarification—is needed regarding the way the fractional shares of production of various interest owners in a horizontally pooled unit are calculated where certain non-executive interest owners refuse their consent to the pooling of interests.<sup>38</sup>

A brief discussion of the mechanics of horizontal drilling will assist in gaining a general understanding of the topic.<sup>39</sup> The Texas Railroad Commission defines a horizontal drainhole well as “[a]ny well that is developed with one or more horizontal drainholes having a horizontal drainhole displacement of at least 100 feet.”<sup>40</sup> In practice, a horizontal wellbore is first drilled vertically to a pre-determined depth that targets a known formation believed to hold hydrocarbons in profitable quantities.<sup>41</sup>

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37. See H. Philip 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, 178 (2011–2012) (focusing on the regulatory limits written for vertical drilling applied to horizontal well technology).

38. See, e.g., Bruce M. Kramer, *Pooling for Horizontal Wells: Can They Teach an Old Dog New Tricks?*, 55 ROCKY MTN. MIN. L. INST. §§ 8.03–.04 (2009) (detailing the problems with the current legal framework).

39. See, e.g., *id.* (exploring the history and issues that arise when drilling horizontal wells for oil and gas).

40. 16 TEX. ADMIN. CODE § 3.86(a)(4) (2013) (R.R. Comm'n of Tex., Horizontal Drainhole Wells).

41. See 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, 232–33 (2002) (describing the process of drilling a horizontal well).

Targeted formation depths differ, but by way of example, in the Eagle Ford Shale, the vertical component is drilled to depths ranging from 4,000 and 12,000 feet below the surface.<sup>42</sup> In deeper formations, the vertical component is reputed to reach depths of up to 20,000 feet.<sup>43</sup>

For a vertical well, the drilling would end here.<sup>44</sup> Such a well may or may not be subjected to hydraulic fracture stimulation, which is a maneuver used to increase the flow of hydrocarbons from various zones or formations encountered along the path to its total depth.<sup>45</sup> Reaching the targeted formation, or interval, however, is only the beginning for a horizontal well.<sup>46</sup> Once the targeted formation is reached, the drill bit is turned in a more or less perpendicular direction, and then drilling continues along an approximate horizontal plane that may extend thousands of feet outward from the initial vertical portion of the well.<sup>47</sup>

In 1990, in recognition of the changing nature of oil and gas production, the Texas Railroad Commission enacted Statewide Rule 86, the first rule of its kind specifically applicable to horizontal drilling.<sup>48</sup> Statewide Rule 86 allows additional acreage to be assigned to a horizontal well, depending on the length of its productive horizontal drain hole.<sup>49</sup> Additionally, oil and

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42. See R.R. COMM'N OF TEX., EAGLE FORD INFORMATION, <http://www.rrc.state.tx.us/eagleford/index.php> (last updated Mar. 27, 2013) (describing the Eagle Ford Shale, and stating that it “rest[s] between the Austin Chalk and the Buda Lime at a depth of approximately 4,000 to 12,000 feet”).

43. See, e.g., *Drilling*, CHESAPEAKE ENERGY, <http://www.chk.com/Operations/Process/Drilling/Pages/Information.aspx> (last visited Apr. 9, 2013) (“Chesapeake’s horizontal wells range in depth from approximately 5,000 to 13,000 feet, while our vertical wells can exceed 20,000 feet in depth.”).

44. See generally Benjamin Robertson, Comment, *Top Lease Vultures: Title Failure, Bad Faith Pooling, and the Validity of Top Leases in the Texas Shale Plays*, 44 TEX. TECH L. REV. 463, 469–72 (2012) (discussing the history and process of vertical drilling).

45. See generally Joe Schremmer, Comment, *Avoidable “Traccident”: An Argument Against Strict Liability for Hydraulic Fracturing*, 60 U. KAN. L. REV. 1215, 1219–20 (2012) (describing the history of hydraulic fracturing dating back to 1947).

46. See Bruce M. Kramer, *Pooling for Horizontal Wells: Can They Teach an Old Dog New Tricks?*, 55 ROCKY MTN. MIN. L. INST. § 8.01[1] (2009) (illustrating the process of horizontal drilling).

47. See *id.* (explaining that the predetermined point at which the drill bit begins to deviate in a horizontal fashion is often referred to as the “kick-off point”).

48. 16 TEX. ADMIN. CODE § 3.86 (2013); see Doug J. Dashiell, *Railroad Commission Regulation of the Texas Eagle Ford Shale*, OIL, GAS AND ENERGY L. SEC. REP. 2 (2012), available at [www.utcle.org/eLibrary/preview.php?asset\\_file\\_id=24745](http://www.utcle.org/eLibrary/preview.php?asset_file_id=24745) (“Rule 86 now applies to all horizontal wells or drainholes drilled in Texas except those horizontal wells in the fields that have special horizontal rules currently in effect. Rule 86 essentially regulates horizontal drainholes in fields for which the RRC has adopted special field rules that apply only to vertical wells and in fields that are subject to statewide regulation.”).

49. Rules 37 and 38 were constructed to conform to vertical drilling. See 16 TEX. ADMIN. § 3.86(b)–(c) (regulating the density of wells based upon horizontal drainholes). “The federal

gas operators seeking to drill a horizontal well in Texas must specifically notify the Texas Railroad Commission of their intention to drill a horizontal well.<sup>50</sup>

Because horizontal drilling increases the exposure of the perforated (i.e., producing) portion of the wellbore by thousands of feet over a traditional vertical well, the efficiency gains in hydrocarbon extraction are exponential.<sup>51</sup> Simply put, as the amount of source rock exposed to the wellbore increases, production rates skyrocket; that is, where we once had perhaps hundreds of feet of productive formation exposed, we now have thousands.<sup>52</sup> These enhanced drilling techniques allow modern operators to achieve far greater oil and gas drainage from a given field, which drastically reduces waste in terms of capturing those hydrocarbons not previously subject to recovery.<sup>53</sup> Additionally, increased lateral length for each well means that producers can now access more of a particular formation through fewer surface locations, which includes the ability to access areas impossible to reach otherwise.<sup>54</sup> One need look no further than the skyline of Fort Worth, Texas, to see that many areas that were once considered inaccessible to exploration—such as underneath public spaces (e.g., parks, downtown business districts, etc.), rivers, and residential neighborhoods—are now accessible for hydrocarbon production.<sup>55</sup> However, hydrocarbon production is not the only benefit

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government does not presently have regulations specific to the regulation of horizontal drilling.” Michael J. Wozniak & Jamie L. Jost, *Horizontal Drilling: Why It's Much Better to “Lay Down” Than to “Stand Up” and What Is an “18° Azimuth” Anyway?*, 57 ROCKY MTN. MIN. L. INST. § 11.03[1][a] (2011).

50. See 16 TEX. ADMIN. § 3.86(f) (requiring an application to drill a horizontal well).

51. See Richard Finger, *We're Headed to \$8 Natural Gas*, FORBES (July 22, 2012), <http://www.forbes.com/sites/richardfinger/2012/07/22/were-headed-to-8-00-natural-gas/> (arguing that horizontal drilling reversed declining gas prices in 2005).

52. See OFFICE OF FOSSIL ENERGY & NAT'L ENERGY TECH. LAB., U.S. DEP'T OF ENERGY, MODERN SHALE GAS DEVELOPMENT IN THE UNITED STATES: A PRIMER 46–47 (2009), available at [http://www.netl.doe.gov/technologies/oil-gas/publications/EPreports/Shale\\_Gas\\_Primer\\_2009.pdf](http://www.netl.doe.gov/technologies/oil-gas/publications/EPreports/Shale_Gas_Primer_2009.pdf) (explaining the ways in which production is increased through horizontal drilling).

53. See *id.* at 47 (stating horizontal wells can produce as much, if not more, hydrocarbons as vertical wells).

54. See 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, 256 (2002) (advocating horizontal drilling has “vastly improved the efficiency of extracting hydrocarbons and has substantially reduced waste associated with traditional drilling techniques”).

55. For example, much of the production from the Barnett Shale comes from beneath the city of Fort Worth. See R.R. COMM'N OF TEX., BARNETT SHALE INFORMATION, <http://www.rrc.state.tx.us/barnettshale/index.php> (last updated Mar. 25, 2013) (showing maps of the Barnett shale with active permits in Fort Worth).

here.<sup>56</sup> As the footprint of oil and gas operations are reduced, so too are the conflicts between operators and surface owners.<sup>57</sup>

Though horizontal drilling provides greater access and higher production rates,<sup>58</sup> the higher capital cost of this complex drilling procedure can push some operators and projects out of the market.<sup>59</sup> Conservatively, the price tag for drilling a horizontal well runs at least double that of a vertical well, often more.<sup>60</sup> Aside from the additional time and material involved, the requisite intensity of the hydraulic fracture stimulation—required by the particular reservoir in question—can have the possibility of increasing drilling costs exponentially.<sup>61</sup> However, with financial risk often come substantial rewards for all parties involved.<sup>62</sup> As such, Texans have an enormous economic incentive to encourage profitable and responsible oil and gas production.<sup>63</sup>

### B. *Pooling*

Because of the dramatic increase in horizontal well drilling, the strategy of pooling together multiple tracts into a single production unit large enough to accommodate such wells has become a vital component of oil

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56. See OFFICE OF FOSSIL ENERGY & NAT'L ENERGY TECH. LAB., U.S. DEP'T OF ENERGY, MODERN SHALE GAS DEVELOPMENT IN THE UNITED STATES: A PRIMER 76 (2009), available at [http://www.netl.doe.gov/technologies/oil-gas/publications/EPreports/Shale\\_Gas\\_Primer\\_2009.pdf](http://www.netl.doe.gov/technologies/oil-gas/publications/EPreports/Shale_Gas_Primer_2009.pdf) (concluding increases in production efficiency of horizontal drilling as compared to vertical drilling make the former more environmentally safe).

57. See *id.* (listing the ways in which horizontal drilling reduces surface impact).

58. Cf. *id.* (stating that fewer wells are needed with horizontal drilling due to the increased production per well).

59. See *id.* at 47 (listing the cost of producing a horizontal well as more than three times the cost of drilling a vertical well, which some smaller producers likely cannot afford).

60. See *id.* (comparing the costs of vertical wells and horizontal wells, \$800,000 and \$2.5 million respectively).

61. See *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 635 (Tex. App.—Austin 2000, pet. denied) (stressing that horizontal wells may “require two to three times the investment” compared to drilling vertical wells); see also OFFICE OF FOSSIL ENERGY & NAT'L ENERGY TECH. LAB., U.S. DEP'T OF ENERGY, MODERN SHALE GAS DEVELOPMENT IN THE UNITED STATES: A PRIMER 47 (2009), available at [http://www.netl.doe.gov/technologies/oil-gas/publications/EPreports/Shale\\_Gas\\_Primer\\_2009.pdf](http://www.netl.doe.gov/technologies/oil-gas/publications/EPreports/Shale_Gas_Primer_2009.pdf) (explaining that a driller invests a significant amount of money when they use hydraulic fracturing).

62. See generally OFFICE OF FOSSIL ENERGY & NAT'L ENERGY TECH. LAB., U.S. DEP'T OF ENERGY, MODERN SHALE GAS DEVELOPMENT IN THE UNITED STATES: A PRIMER 9–10 (2009), available at [http://www.netl.doe.gov/technologies/oil-gas/publications/EPreports/Shale\\_Gas\\_Primer\\_2009.pdf](http://www.netl.doe.gov/technologies/oil-gas/publications/EPreports/Shale_Gas_Primer_2009.pdf) (arguing that the confluence of technological advances in horizontal drilling and hydraulic fracturing with increasing gas prices has created a multi-billion dollar venture).

63. See *Luecke*, 38 S.W.3d at 647 (“[W]e recognize the immense benefits that have accompanied the advent of horizontal drilling, including the reduction of waste and the more efficient recovery of hydrocarbons.”).

and gas development in the state of Texas.<sup>64</sup> Early on, Texas followed the trend of other mineral-rich states<sup>65</sup> by passing legislation that sought to promote the conservation of its resources and to protect the correlative rights of its citizens.<sup>66</sup> Rule 37<sup>67</sup> and Rule 38,<sup>68</sup> promulgated by the Texas Railroad Commission,<sup>69</sup> promote these aims through the establishment of well spacing and density rules, which require minimum distances between a well and lease or tract boundary, as well as between the actual wells themselves.<sup>70</sup> Together, and perhaps unintentionally, these regulations inevitably promote voluntary pooling among oil and gas operators.<sup>71</sup>

Pooling can be thought of as “bringing together *two or more* small or irregularly-shaped tracts of land to form a drill site in connection with a program of uniform well spacing.”<sup>72</sup> Essentially, several separately-owned tracts are combined together into a pooled unit to support one or more wells that none of the tracts alone would have been able to accommodate.

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64. See James E. Key, *The Right to Royalty: Pooling and the Capture of Unburdened Interests*, 17 TEX. WESLEYAN L. REV. 69, 70 (2010) (“One reason pooling became so common, besides regulatory issues concerning minimum well spacing, was the judicially created doctrine of non[apportionment.”]; Bruce M. Kramer, *Pooling for Horizontal Wells: Can They Teach an Old Dog New Tricks?*, 55 ROCKY MTN. MIN. L. INST. § 8.01[3] (2009) (previewing the topic of pooling in the realm of horizontal drilling).

65. See Ralph B. Shank, *Pooling Problems*, 28 TEX. L. REV. 662, 663 (1950) (stating that many states passed pooling statutes during World War II).

66. See *id.* (explaining Texas passed its pooling bill to prevent economic waste and to conserve natural resources by limiting the amount of wells drilled).

67. 16 TEX. ADMIN. CODE § 3.37 (2013) (R.R. Comm’n of Tex., Statewide Spacing Rule).

68. *Id.* § 3.38 (R.R. Comm’n of Tex., Well Densities).

69. The Texas Railroad Commission has the power to enact rules necessary to prevent waste and guard against operations that are dangerous to property and life. TEX. NAT. RES. CODE ANN. § 85.042 (West 2011).

70. 16 TEX. ADMIN. § 3.37; see 2 ERNEST E. SMITH & JACQUELINE LANG WEAVER, TEXAS LAW OF OIL AND GAS § 9.3[A][1] (2d ed. 2012) (“Rule 37 requires minimum distances between the applicant’s proposed well and any other well drilled to the same horizon, and also between the proposed well and any ‘property line, lease line, or subdivision line,’ unless an exception is obtained.”).

71. See generally *Wagner & Brown, Ltd. v. Sheppard*, 282 S.W.3d 419, 424 (Tex. 2008) (“[P]ooling benefits mineral owners, operators, the state, and the environment by reducing the number of wells needed to maintain efficient production while protecting correlative rights.”); Ralph B. Shank, *Pooling Problems*, 28 TEX. L. REV. 662, 677 (1950) (“[M]ost of the benefits to the lessor lie in the additional recoveries which are supposed to result from proper well spacing and controlled production.”).

72. *Whelan v. Manziel*, 314 S.W.2d 126, 132 (Tex. Civ. App.—Texarkana 1958, writ ref’d n.r.e.); see also 2 ERNEST E. SMITH & JACQUELINE LANG WEAVER, TEXAS LAW OF OIL AND GAS § 11.1[B] (2d ed. 2012) (stating the purpose for pooling is to combine various smaller tracts owned separately in order to drill a well which complies with Texas Railroad Commission spacing requirements).

The proceeds of production from the pooled unit are then allocated amongst the various mineral and royalty owners on an agreed upon basis, most commonly based on the percentage of the tract in question to the unit as a whole on a surface acreage basis.<sup>73</sup> From a national perspective, although oil and gas production has been around since the 1800s,<sup>74</sup> pooling itself did not attract attention in the United States until the early 1900s, when state regulation stepped in to restrict the aggressive practices of mineral extraction in the oil field.<sup>75</sup>

Prior to state involvement in the regulation of mineral exploration and production, the oil and gas industry existed under a hands-off system.<sup>76</sup> In this environment of high stakes and low supervision, strong-arm tactics and inefficiency often ruled the day.<sup>77</sup> The economic incentives arbitrarily given to the earlier operators strongly discouraged planned and measured hydrocarbon extraction.<sup>78</sup> If one chose not to drill for oil immediately, it was almost certain that a neighbor would opt to do so, despite the fact that such drilling was detrimental to the adjacent stakeholder.<sup>79</sup> The idea of

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73. 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, 224–25 (2009–2010).

74. As a byproduct of drilling the first oil well in 1859 in Titusville, Pennsylvania, courts were given the task of developing the legal framework to be applied to oil and gas jurisprudence. *Id.* at 220–21.

75. See Ralph B. Shank, *Pooling Problems*, 28 TEX. L. REV. 662, 663 (1950) (“Conservation statutes of the respective states and the conservation orders promulgated under such statutes . . . have aided in bringing about pooling.”).

76. See DIANA DAVIDS OLIEN & ROGER M. OLIEN, OIL IN TEXAS: THE GUSHER AGE, 1895–1945, at 9 (2002) (providing Texas’s first oil field regulation “provided no monitoring or enforcement . . . leaving it to individuals to bring suit against offenders” (citing 1899 Tex. Gen. Laws 228)); *An Informal History Compiled for Its Centennial*, R.R. COMM’N OF TEX. (last visited Apr. 9, 2013), <http://www.rrc.state.tx.us/about/history/centennial/centennial05.php> (stating that early Texas oil field regulations were not observed).

77. In Texas, the discovery of oil in the early 1920s was akin to a gold rush, such that where derricks were positioned side-by-side, riots regularly broke out as a means to acquire production. Cullen M. “Mike” Godfrey, *A Brief History of the Oil and Gas Practice in Texas*, 68 TEX. B.J. 812, 813 (2005); see DIANA DAVIDS OLIEN & ROGER M. OLIEN, OIL IN TEXAS: THE GUSHER AGE, 1895–1945, at 20 (2002) (“[O]il producers and rival refiners had perfected political infighting to gain competitive advantages.”).

78. See DIANA DAVIDS OLIEN & ROGER M. OLIEN, OIL IN TEXAS: THE GUSHER AGE, 1895–1945, at 19 (2002) (“[Early oilmen] produced wells at top volume when it was inconvenient or even ruinous to do so . . . . With respect to economics, the oilman hoped to recover his investment and make money by selling his oil; he did neither if he left it in the ground.”).

79. See *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 632 (Tex. App.—Austin 2000, pet. denied) (citing *Elliff v. Texon Drilling Co.*, 146 Tex. 575, 210 S.W.2d 558, 561–62 (1948)) (holding the rule of capture provides: “Owners of tracts of land with producing wells may thus drain and appropriate the oil and gas that have flowed from neighboring tracts without the consent of the owner of those lands and without incurring liability for drainage”); DIANA DAVIDS OLIEN & ROGER M. OLIEN, OIL IN TEXAS: THE GUSHER AGE, 1895–1945, at 19 (2002) (“[T]he main incentive to produce all the oil

measured well spacing, much less pooling of interests, simply did not exist.<sup>80</sup> It was the rampant waste of oil revealed during the immediate aftermath of the 1894 Corsicana Field discovery<sup>81</sup> that prompted the first corrective legislative action: the passage of “An Act to Regulate Drilling, Operation and Abandonment of Petroleum Oil, Natural Gas and Mineral Water Wells, and to Prevent Certain Abuses Connected Therewith”<sup>82</sup> in March of 1899.

This initial effort at stemming waste reflected the first legislative efforts to establish a legal framework for the oil and gas industry that contemplated the pace of emerging technology.<sup>83</sup> Further attempts on the

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one could as fast as possible was that the oilmen all around would do so.”); Bruce M. Kramer, *Pooling for Horizontal Wells: Can They Teach an Old Dog New Tricks?*, 55 ROCKY MTN. MIN. L. INST. § 8.01[2] (2009) (citation omitted) (“Because the only protection a mineral owner had under a rule-of-capture property regime was to drill a well to prevent drainage from a well located on a neighboring tract, there was a built-in incentive for such owners to drill as many wells as quickly and as close to the property line as possible.”).

80. See *Brown v. Humble Oil & Ref. Co.*, 126 Tex. 296, 83 S.W.2d 935, 939 (1935) (pointing out there was no well spacing regulation in Texas until the adoption of Rule 37 on November 26, 1919); see also Bruce M. Kramer, *Pooling for Horizontal Wells: Can They Teach an Old Dog New Tricks?*, 55 ROCKY MTN. MIN. L. INST. § 8.01[2] (2009) (“The need for well spacing and pooling regulation was a direct result of the early and widespread adoption of the rule of capture as the basic ownership principle for oil and gas.”).

81. See DIANA DAVIDS OLIEN & ROGER M. OLIEN, *OIL IN TEXAS: THE GUSHER AGE, 1895–1945*, at 9 (2002) (“[O]perators spilled crude [oil] and stored it in tanks that leaked. When drilling through aquifers to find oil, the operators were not meticulous about casing off water-bearing formations. Worse yet, if they got dry holes, they usually salvaged casing to use elsewhere and abandoned the holes unplugged.”); WALTER RUNDELL, JR., *EARLY TEXAS OIL: A PHOTOGRAPHIC HISTORY, 1866–1936*, at 27 (1977) (“Corsicana . . . demonstrated the possibilities of flush production, commercial refining, and successful marketing. In the process it had also demonstrated a reckless waste of natural resources.”).

82. An Act to Regulate Drilling, Operation and Abandonment of Petroleum Oil, Natural Gas and Mineral Water Wells, and to Prevent Certain Abuses Connected Therewith, 26th Leg., ch. XLIX, 1899 Tex. Gen. Laws 68 (1899); accord 2 ERNEST E. SMITH & JACQUELINE LANG WEAVER, *TEXAS LAW OF OIL AND GAS* § 8.1[B] (2d ed. 2012) (“The field was developed wastefully without any regulation. Fire was a particular hazard, especially as oil frequently soaked the ground around the wells and was often stored in earthen pits.”).

83. Cf. DIANA DAVIDS OLIEN & ROGER M. OLIEN, *OIL IN TEXAS: THE GUSHER AGE, 1895–1945*, at 9 (2002) (“The measure . . . required operators to case off upper oil- or water-bearing formations before drilling into oil pay; prohibited abandoning wells without plugging them with rock, earth, or cement; provided penalties for an operator or owner who did an inadequate plugging job; prohibited gas (but not oil) producers from letting gas flow without use for more than ten days; and restricted flaring gas in the field.”); WALTER RUNDELL, JR., *EARLY TEXAS OIL: A PHOTOGRAPHIC HISTORY, 1866–1936*, at 27 (1977) (explaining that Texas’s first regulatory law governing oil and gas production was passed in 1899 and intended to prevent waste “provided for encasing wells, plugging abandoned wells, and capping gas wells until they were piped for commercial usage, and limited the burning of gas for illumination between 8 A.M. and 5 P.M.”).

part of the legislature to curb waste<sup>84</sup> and promote conservation<sup>85</sup> continued throughout the late 1800s and early 1900s, but each effort lacked a strong enforcement mechanism.<sup>86</sup>

Statewide Rule 37, passed in 1919, was the first well spacing regulation passed in the nation, marking a departure from the prevailing laissez-faire regulatory frameworks employed in other states.<sup>87</sup> The Texas Supreme Court affirmed the state's right to regulate such practices in the 1935 decision of *Brown v. Humble Oil & Refining Co.*<sup>88</sup> In *Humble Oil*, the court held, "[T]he Railroad Commission has the power, under the conservation statutes, to promulgate a spacing rule, as was done, regulating the drilling of oil wells, and to provide for an exception to the rule to protect vested rights and to prevent waste . . . ."<sup>89</sup> The court broadly reinforced the legitimacy of the Texas Railroad Commission and its power to "make and enforce rules, regulations or orders for the conservation of crude petroleum oil and natural gas and to prevent the waste thereof . . . ."<sup>90</sup>

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84. See DIANA DAVIDS OLIEN & ROGER M. OLIEN, OIL IN TEXAS: THE GUSHER AGE, 1895–1945, at 92 (2002) ("By the late 1910s, Progressive conservatives began to criticize oilmen for letting gas produced in the production of oil flare off or simply flow into the air; and for overproducing oil that was then stored wastefully in open puts or leaky tanks, where volatile components evaporated. The Texas legislature responded in 1919 by amending 'article 16 of the state constitution to permit the legislature to make laws to conserve natural resources.'").

85. See *id.* (stating that in 1919, the Texas Railroad Commission passed Rule 37, a well spacing scheme, that was riddled with exceptions due to the legislature's desire to avoid the appearance of an unconstitutional taking).

86. See *id.* at 94–95 (noting that the RRC "lacked regulatory credibility" because its staff did not have oil-industry experience and "had far too few deputy supervisors in its field force to support efficient enforcement"); *An Informal History Compiled for Its Centennial*, R.R. COMM'N OF TEX. (last visited Apr. 9, 2013), <http://www.rrc.state.tx.us/about/history/centennial/centennial05.php> (noting early Texas oil field regulation was not frequently observed).

87. *History of the Railroad Commission: Chronological Listing of Key Events in the History of the Railroad Commission of Texas (1866–1939)*, R.R. COMM'N OF TEX., <http://www.rrc.state.tx.us/about/history/chronological/chronhistory01.php> (last visited Apr. 9, 2013); see also 16 TEX. ADMIN. CODE § 3.37(a)(1) (2013) (Tex. R.R. Comm'n, Statewide Spacing Rule) (providing "no well shall be drilled nearer than 467 feet to any property line, lease line, or subdivision line" and that no well shall "be drilled nearer than 1,200 feet to any well completed in or drilling to the same" field on the same tract); *Gulf Land Co. v. Atl. Ref. Co.*, 134 Tex. 59, 131 S.W.2d 73, 80 (1939) (defining confiscation for the purposes of Rule 37 as "depriving the owner or lessee of a fair chance to recover the oil and gas in or under his land or their equivalents in kind"); Robert E. Hardwicke, *Oil-Well Spacing Regulations and Protection of Property Rights in Texas*, 31 TEX. L. REV. 99, 103 (1952) (acknowledging that exceptions are necessary to prevent waste and confiscation). The rule was "promulgated for two purposes, one to reduce . . . fire hazard[s], and the other to minimize the danger of water percolation into the oil stratum from wells drilled in too great a number, or in too close proximity." R.R. Comm'n of Tex. v. Bass, 10 S.W.2d 586, 587 (Tex. Civ. App.—Austin 1928, no writ).

88. *Brown v. Humble Oil & Ref. Co.*, 126 Tex. 296, 83 S.W.2d 935 (1935).

89. *Id.* at 944.

90. *Id.* at 939 (citation omitted).

According to the court, Rule 37 served to protect correlative rights by allowing each mineral and royalty owner the opportunity to recover its respective minerals in an efficient manner.<sup>91</sup>

Unfortunately, the application of new drilling techniques frequently outpaces the ability of courts and legislators to regulate effectively exploration and production.<sup>92</sup> For decades, the application of Rule 37 created an incentive for owners of smaller plots of land to seek exception permits rather than honoring the spirit and letter of the spacing rules.<sup>93</sup> When old regulations are applied to new techniques, it produces unintended consequences; thus, Texas jurisprudence requires periodic revisions to stay abreast of such changes.<sup>94</sup> A more efficient application

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91. See *id.* at 944 (“[The rule] guarantees the opportunity in each owner to recover his oil by providing an exception to a uniform spacing regulation that would otherwise prevent him from doing so.”).

92. See TECH. SUBGROUP OF THE OPERATIONS & ENV’T TASK GROUP, NAT’L PETROL. COUNCIL, PLUGGING AND ABANDONMENT OF OIL AND GAS WELLS 6 (Sept. 15, 2011) [http://www.npc.org/Prudent\\_Development-Topic\\_Papers/2-25\\_Well\\_Plugging\\_and\\_Abandonment\\_Paper.pdf](http://www.npc.org/Prudent_Development-Topic_Papers/2-25_Well_Plugging_and_Abandonment_Paper.pdf) (“The promulgation of plugging and abandonment regulations trailed behind advancements in drilling and production practices because the adverse environmental and safety implications of improperly abandoned wells had not yet been revealed. As more and more dry holes were abandoned, other states began recognizing the need to institute a set of standards associated with plugging oil and gas wells.”); see also A. L. Parlow, *Rethinking a Twenty-First Century Model for Energy Development*, 87 N.D. L. REV. 691, 696 (2011) (“[A]dvocates on all sides of the oil and gas issue generally agree that advanced technologies lag in their ability to anticipate, prevent, or respond to problems created by the complex high-tech energy extraction ventures. Examples include drilling to 8,000 feet below the sea; hydraulic fracturing that injects water and chemicals under high pressure into deep rock; and drilling in extreme Arctic weather conditions in seas where a spill could eclipse the tragedy in the Gulf.”); cf. David Spence, *Fracking Regulations: Is Federal Hydraulic Fracturing Regulation Around the Corner?*, UNIV. OF TEX. AT AUSTIN 2 (2010), <http://www.mcombs.utexas.edu/Centers/EMIC/Resources.aspx> (observing that hydraulic fracturing, called “fracking,” has been around for decades, but is governed by a “relatively light handed regulatory regime”).

93. See Ernest E. Smith, *The Texas Compulsory Pooling Act*, 43 TEX. L. REV. 1003, 1005 (1965) (stipulating that Rule 37 exemptions created a disincentive to pool because “under the proration formulas usually adopted[,] the owner of a one-acre tract frequently would receive far more profit by drilling a well on his own tract than by pooling his land with his neighbors and sharing the expenses of drilling on a forty-acre unit.”); see also DIANA DAVIDS OLIEEN & ROGER M. OLIEEN, *OIL IN TEXAS: THE GUSHER AGE, 1895–1945*, at 93 (2002) (indicating that exemptions were also commonly granted because of the conflicting engineering science at the time; “some [engineering] authorities held that close spacing maximized recovery”); 2 ERNEST E. SMITH & JACQUELINE LANG WEAVER, *TEXAS LAW OF OIL AND GAS* § 9.3[A] (2d ed. 2012) (explaining the TRC was concerned that by failing to grant a well spacing exemption to a small-tract owner, who feared his land was being drained by a neighboring large-tract owner, the TRC was vulnerable to legal action by small-tract owners claiming unconstitutional takings).

94. See, e.g., TECH. SUBGROUP OF THE OPERATIONS & ENV’T TASK GROUP, NAT’L PETROL. COUNCIL, PLUGGING AND ABANDONMENT OF OIL AND GAS WELLS, 6 (Sept. 15, 2011), available at [http://www.npc.org/Prudent\\_Development-Topic\\_Papers/2-25\\_Well\\_Plugging\\_and\\_Abandonment\\_Paper.pdf](http://www.npc.org/Prudent_Development-Topic_Papers/2-25_Well_Plugging_and_Abandonment_Paper.pdf) (commenting on the past ignorance of environmental problems caused by

of the spacing rules, as applied to the enhanced drilling techniques, was necessary to meet the challenges posed by over-production.<sup>95</sup> With stepped up enforcement and a decline in the ability to abuse the Rule 37 exception process,<sup>96</sup> operators discovered that a better approach was to form pooled units in areas where tracts were too small to comply with Rule 37.<sup>97</sup>

Although originally conceived as a method to reduce fire hazards caused by drilling rigs physically located too close to each other,<sup>98</sup> Rules 37 and 38 became tools used to maximize hydrocarbon recovery from specific fields.<sup>99</sup> Unfortunately, due to loopholes and lax enforcement, these measures largely failed to prevent over-drilling.<sup>100</sup> However, they proved effective in encouraging pooling and promoting the efficient recovery of

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outdated regulations being applied to modern practices); cf. David Spence, *Fracking Regulations: Is Federal Hydraulic Fracturing Regulation Around the Corner?*, UNIV. OF TEX. AT AUSTIN (2010), <http://www.mcombs.utexas.edu/Centers/EMIC/Resources.aspx> (exposing the lack of stringent regulation as the cause of some environmental fears surrounding fracking).

95. See 2 ERNEST E. SMITH & JACQUELINE LANG WEAVER, TEXAS LAW OF OIL AND GAS § 9.3[A] (2d ed. 2012) (arguing the generous granting of Rule 37 well spacing exemptions led to excessive waste that bolstered support for the adoption of a compulsory pooling statute).

96. See Ernest E. Smith, *The Texas Compulsory Pooling Act*, 43 TEX. L. REV. 1003, 1005 (1965) (“[U]nder the one-third–two-thirds formula a well drilled as a Rule 37 exception . . . would produce at a rate of over 200 times as much . . . as a well drilled in accordance with the 320-acre spacing pattern.”) (citation omitted); see also TEX. NAT. RES. CODE ANN. § 102.013(c) (West 2011) (requiring the applicant to offer a “fair and reasonable offer to pool voluntarily” that is rejected by the tract-owner before pooling is ordered).

97. H. Philip 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, 187–88 (2011–2012); see also Ralph B. Shank, *Pooling Problems*, 28 TEX. L. REV. 662, 663 (1950) (stating that conservation statutes contributed to the passage of pooling statutes). See generally TEX. NAT. RES. § 102.013 (codifying the requirement of making a voluntary pooling offer before being approved by the commission to drill).

98. *History of the Railroad Commission: Chronological Listing of Key Events in the History of the Railroad Commission of Texas (1866–1939)*, R.R. COMM’N OF TEX., <http://www.rrc.state.tx.us/about/history/chronological/chronhistory01.php> (last visited Apr. 9, 2013); see 2 ERNEST E. SMITH & JACQUELINE LANG WEAVER, TEXAS LAW OF OIL AND GAS § 9.3[A] (2d ed. 2012) (“[Rule 37] was originally adopted to reduce fire hazards and the danger of water percolation into oil strata.”).

99. See 2 ERNEST E. SMITH & JACQUELINE LANG WEAVER, TEXAS LAW OF OIL AND GAS § 9.3[A] (2d ed. 2012) (“Later on, [Rule 37’s] purposes came to include reducing the economic waste of drilling and producing unnecessary wells, and reducing physical waste by preventing excessive and disproportionate rates of withdrawal from parts of a reservoir where wells are clustered.”).

100. See *id.* (discussing how Rule 37 exception permits are allowed); see also Ernest E. Smith, *The Texas Compulsory Pooling Act*, 43 TEX. L. REV. 1003, 1004 (1965) (contending the liberal issuance of Rule 37 exceptions frustrated the regulation’s *raison d’être*—safety hazards on the small-tract considerably increased and drilling several wells to extract the same amount of oil was immensely wasteful).

resources.<sup>101</sup>

As the state of Texas ramped up enforcement of regulations to prevent waste and protect correlative rights,<sup>102</sup> lessors and lessees began to appreciate the benefits of voluntarily pooling ever-larger amounts of acreage.<sup>103</sup> Whereas the unbridled rule of capture encouraged drilling on any tract large enough for a rig,<sup>104</sup> the more levelheaded operators

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101. See Ralph B. Shank, *Pooling Problems*, 28 TEX. L. REV. 662, 663 (1950) (“Conservation statutes of the respective states and the conservation orders promulgated under such statutes likewise have aided in bringing about pooling.”). See generally TEX. NAT. RES. § 102.013 (enumerating the requirements of an applicant in making a voluntary pooling offer to other interest holders).

102. See *Atl. Ref. Co. v. R.R. Comm’n of Tex.*, 162 Tex. 274, 346 S.W.2d 801, 811 (1961) (holding proration formulas, that created a financial windfall for the small-tract owners, constituted drainage which prevented the large-tract owner from producing their fair share); see also *Halbouty v. R.R. Comm’n*, 163 Tex. 417, 357 S.W.2d 364, 374 (1962) (“[I]f in a common reservoir one tract owner is allowed to produce many times more gas than underlies his tract[,] he is denying to some other landowner in the reservoir a fair chance to produce the gas underlying his land.”); *R.R. Comm’n v. Humble Oil & Ref. Co.*, 193 S.W.2d 824, 829 (Tex. Civ. App.—Austin 1946), *aff’d sub nom. Williams v. R.R. Comm’n of Tex.*, 331 U.S. 791 (1947), *aff’d per curiam*, 331 U.S. 791 (1947) (“The proper test of the order’s validity . . . is whether it denies to . . . others . . . a fair opportunity to produce its recoverable oil.”).

103. See *Wagner & Brown, Ltd. v. Sheppard*, 282 S.W.3d 419, 424 (Tex. 2008) (“[P]ooling benefits mineral owners, operators, the state, and the environment by reducing the number of wells needed to maintain efficient production while protecting correlative rights.”); 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, 225 (2009–2010) (“Forming pooled units is essential in the oil and gas industry. It prevents waste, insures efficient production of oil and gas, and protects correlative rights of mineral estate owners.”); Ralph B. Shank, *Pooling Problems*, 28 TEX. L. REV. 662, 677 (1950) (“[B]enefits to the lessor [who pools] lie in the additional recoveries which are supposed to result from proper well spacing and controlled production.”). As a general rule, however, lessors are usually not in favor of pooling clauses because pooling may reduce the lessor’s royalty. Because of this, a compromise clause known as a Pugh Clause is sometimes put into the lease. E.g., *Pugh Clause*, MINERALWISE, <http://www.mineralweb.com/owners-guide/lease-proposals/pugh-clause/> (last visited Apr. 9, 2013) (“Absent a Pugh Clause, a Lessor could be exposed to the entirety of the lands under an oil or gas lease being held by the production from a small portion of the lands covered by the lease being pooled or combined with other lands.”). A Pugh Clause modifies the typical pooling clause by stating that drilling operations or production from a pooled unit does not preserve the entire lease; the lease can still expire after the primary term. See generally *id.* (providing a general background of the Pugh Clause and discussing its various uses).

104. See 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, 221 (2002) (opining the rule of capture resulted in wells “spaced too closely, which led to overproduction, damage to reservoirs, and plummeting prices” (citing EUGENE O. KUNTZ ET AL., CASES AND MATERIALS ON OIL AND GAS LAW 54 (3d ed. 1998))). See generally *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 632 (Tex. App.—Austin 2000, pet. denied) (“The rule of capture . . . provides that . . . [o]wners of tracts of land with producing wells may thus drain and appropriate the oil and gas that have flowed from neighboring tracts without the consent of the owner of those lands and without incurring liability for drainage.” (citing *Elliff v. Texon Drilling Co.*, 146 Tex. 575, 210 S.W.2d 558, 561–62 (1948))).

embraced the minimum acreage requirements.<sup>105</sup> If a particular tract was too small to satisfy the spacing and density requirements of Rules 37 and 38, lessees could utilize pooling to combine different leased tracts, aggregating the separate leases into one single drilling unit that complied with the Texas Railroad Commission requirements.<sup>106</sup>

The practice of pooling produces a variety of beneficial effects.<sup>107</sup> If altruistic efficiency and conservation efforts to protect a common reservoir were not incentives enough (and they never are), operators eventually realized that pooling allowed them to hold larger quantities of acreage through production from a single well.<sup>108</sup> Rather than drill a hole in every leased tract, an operator can theoretically combine hundreds of acres into a single production unit based on as little as one well.<sup>109</sup> The gain is more acreage held, with lower drilling costs and increased production efficiency on an individual well level.<sup>110</sup> The reservoir also benefits; because as measured oil and gas production increases, so does the total yield from a given field.<sup>111</sup> With the incentive to drill-or-lose reduced by the early twentieth century reforms, operators began to realize significant additional advantages of pooling, such as overcoming geological

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105. See 2 ERNEST E. SMITH & JACQUELINE LANG WEAVER, TEXAS LAW OF OIL AND GAS § 9.3[A] (2d ed. 2012) (tracing the RRC's increase in minimum distance requirements and finding that the prorating yardstick largely eliminated the incentive to over drill).

106. *Luecke*, 38 S.W.3d at 634; 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, 230 (2002). See generally George A. Snell, III, *Pooling—From A to Horizontal*, E. TEX. ASS'N OF PETROL. LANDMEN, 8 (Spring 2011) (on file with the *St. Mary's Law Journal*) (explaining consent by a lessor to pool does not affect separately owned tracts; similarly, establishing a proration unit does not create a pooled unit).

107. See *Wagner & Brown, Ltd.*, 282 S.W.3d at 424 (noting many beneficiaries of pooling); George A. Snell, III, *Pooling—From A to Horizontal*, E. TEX. ASS'N OF PETROL. LANDMEN, 6 (Spring 2011) (on file with the *St. Mary's Law Journal*) (listing the benefits of pooling to the lessee). *But cf.* Howard R. Williams, *Conservation of Oil and Gas*, 65 HARV. L. REV. 1155, 1173–74 (1952) (arguing that compulsory pooling statutes are necessary to overcome lessors' incentive to gamble that the most favorable location for production underlies their land).

108. Ralph B. Shank, *Pooling Problems*, 28 TEX. L. REV. 662, 671 (1950) (citation omitted); Benjamin Robertson, Comment, *Top Lease Vultures: Title Failure, Bad Faith Pooling, and the Validity of Top Leases in the Texas Shale Plays*, 44 TEX. TECH L. REV. 463, 480 (2012).

109. Ralph B. Shank, *Pooling Problems*, 28 TEX. L. REV. 662, 671 (1950) (citations omitted); Benjamin Robertson, Comment, *Top Lease Vultures: Title Failure, Bad Faith Pooling, and the Validity of Top Leases in the Texas Shale Plays*, 44 TEX. TECH L. REV. 463, 480 (2012).

110. See Howard R. Williams, *Conservation of Oil and Gas*, 65 HARV. L. REV. 1155, 1168 (1952) (“Pooling is important in the prevention of drilling of unnecessary and uneconomic wells, which will usually result in physical and economic waste.”).

111. See *id.* (“Only . . . [through unitization] can appropriate use of reservoir pressures be made and secondary recovery operations utilized at the appropriate early stage in the exploitation of the oil deposits.”).

restrictions, and increased business flexibility.<sup>112</sup> As Texas lawmakers updated the legal framework to keep pace with technology, incentives realigned to promote the good stewardship of resources in the state.<sup>113</sup>

However, voluntary pooling is not without its attendant difficulties.<sup>114</sup> A fundamental tenet of Texas oil and gas law is that pooling must be accomplished voluntarily through mutual consent of both the mineral owner and operator, which in many cases is a lessor–lessee relationship.<sup>115</sup> Because Texans are zealous defenders of private property rights, it is obvious that without the lessor’s agreement, the lessee is unable to pool acreage.<sup>116</sup> Of critical importance to the issue of this Article, Texas courts ruled that the right to grant or withhold consent to pooling extends to a royalty owner’s interest and requires express consent in those instances in which his or her interest in production from a well located on his or her tract will be diluted in a pooled unit.<sup>117</sup>

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112. JOSEPH SHADE, *PRIMER ON THE TEXAS LAW OF OIL AND GAS* 123 (4th ed. 2008); see 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, 230 n.97 (2002) (noting pooling enables greater flexibility to deal with “peculiar geological formations, better use of scarce equipment, and controlling the density of drilling”).

113. See Howard R. Williams, *Conservation of Oil and Gas*, 65 HARV. L. REV. 1155, 1182–83 (1952) (offering “a policy for the future”); see also *Wagner & Brown, Ltd. v. Sheppard*, 282 S.W.3d 419, 424 (Tex. 2008) (deciding a cotenant accounting action on equity grounds); George A. Snell, III, *Pooling—From A to Horizontal*, E. TEX. ASS’N OF PETROL. LANDMEN, 6 (Spring 2011) (on file with the *St. Mary’s Law Journal*) (“Production on any part of the lease included in a pooled unit will extend the term as to all tracts or leases, and the lessee is relieved of the obligation to drill offset wells on other tracts covered by the lease or pooled unit.”). See generally TEX. NAT. RES. § 102.013(b) (West 2011) (“The commission shall dismiss the application if it finds that a fair and reasonable offer to pool voluntarily has not been made by the applicant.”).

114. See Howard R. Williams, *Conservation of Oil and Gas*, 65 HARV. L. REV. 1155, 1173–74 (1952) (arguing that compulsory pooling statutes are necessary to overcome lessors’ incentive to gamble that the most favorable location for production underlies their land); see also Ernest E. Smith, *The Texas Compulsory Pooling Act*, 43 TEX. L. REV. 1003, 1005 (1965) (arguing Rule 37 exemptions created a disincentive to pool because a small-tract owner would receive a larger payout under the proration formulas than by pooling).

115. See *Tittizer v. Union Gas Corp.*, 171 S.W.3d 857, 860 (Tex. 2005) (“A lessee has no power to pool without the lessor’s express authorization, usually contained in the lease’s pooling clause.”); *Knight v. Chi. Corp.*, 144 Tex. 98, 188 S.W.2d 564, 566 (1945) (“Absent the express authority to do so, a lessee would have no right to pool the interests in the estate retained by the lessor with those of other lessors.”); Bruce M. Kramer, *Keeping Leases Alive in the Era of Horizontal Drilling and Hydraulic Fracturing: Are the Old Workhorses (Shut-in, Continuous Operations, and Pooling Provisions) Up to the Task?*, 49 WASHBURN L.J. 283, 286 (2010) (“It is axiomatic that without a pooling or unitization clause, the lessee must receive the consent of the lessor in order to pool or unitize the lessor’s interest.”).

116. *Tittizer*, 171 S.W.3d at 860 (citing *Se. Pipe Line Co. v. Tichacek*, 997 S.W.2d 166, 170 (Tex. 1999)).

117. See *Montgomery v. Rittersbacher*, 424 S.W.2d 210, 213 (Tex. 1968) (“[P]ooling on the part of the holder of the executive rights cannot be binding upon the non-participating royalty owner in the absence of his consent.”); *MCZ, Inc. v. Triolo*, 708 S.W.2d 49, 53 (Tex. App.—Houston [1st

However, Texas lawmakers have only partially accepted the idea of less than 100% voluntary pooling, which resulted in the passage of the Mineral Interest Pooling Act (MIPA) in 1965.<sup>118</sup> With this Act, Texas adopted the minority national view in its refusal to denigrate the rights of property owners by declining to take away their right to grant or withhold consent to pooling.<sup>119</sup> The majority of states, however, allow or encourage compulsory pooling.<sup>120</sup> Although MIPA appears to be a forced pooling statute,<sup>121</sup> it was branded as an attempt to encourage voluntary pooling—and not as a proper compulsory pooling statute.<sup>122</sup> Not even the Texas Railroad Commission can compel pooling by its own motion.<sup>123</sup> Instead, the mineral interest owners themselves must initiate forced pooling.<sup>124</sup>

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Dist.] 1986, writ rePd n.r.e.) (“The holder of executive rights cannot pool the interests of a non-participating royalty owner without the latter’s consent.”).

118. See TEX. NAT. RES. § 102.013 (West 2011) (requiring an offer to voluntarily pool that is both fair and reasonable).

119. *Id.* See generally Ernest E. Smith, *The Texas Compulsory Pooling Act*, 43 TEX. L. REV. 1003, 1004 (1965) (“Although forced pooling [was] . . . adopted as early as 1927[,] . . . neither the Texas courts nor the Railroad Commission was willing to accept such a solution without express statutory authorization.”) (footnotes omitted).

120. 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, 225 (2009–2010); Bruce M. Kramer, *Pooling for Horizontal Wells: Can They Teach an Old Dog New Tricks?*, 55 ROCKY MTN. MIN. L. INST. § 8.01[2] (2009) (“Kansas became the only major producing state that did not have a compulsory pooling statute.”); Ernest E. Smith, *The Texas Compulsory Pooling Act*, 43 TEX. L. REV. 1003, 1025 (1965). Oklahoma adopted its first compulsory pooling statute in 1935, and its current statute gives the state comprehensive pooling authority. OKLA. STAT. ANN. tit. 52, § 87.1(e) (West 2011) (requiring owners to pool their lands as a unit when doing so would “avoid the drilling of unnecessary wells, or to protect correlative rights”).

121. Ernest E. Smith, *The Texas Compulsory Pooling Act*, 43 TEX. L. REV. 1003, 1009 (1965). See generally 3 ERNEST E. SMITH & JACQUELINE LANG WEAVER, TEXAS LAW OF OIL AND GAS § 12.1[B] (2d ed. 2012) (differentiating the MIPA from other “compulsory pooling acts that had long existed in other states”).

122. See Ernest E. Smith, *The Texas Compulsory Pooling Act*, 43 TEX. L. REV. 1003, 1019 (1965) (noting the emphasis placed on voluntary agreements).

123. Compare TEX. NAT. RES. § 102.011 (West 2011) (granting the Railroad Commission authority to authorize pooling only after efforts for voluntary pooling have failed), and *Carson v. R.R. Comm’n of Tex.*, 669 S.W.2d 315, 316 (Tex. 1984) (finding a fair, reasonable offer to pool is a jurisdictional prerequisite under MIPA), with COLO. REV. STAT. § 34–60–116(1) (2012) (giving authority to the Commission to pool on its own motion), and WYO. STAT. ANN. § 30–5–109(a) (2011) (permitting pooling on the commission’s own initiative).

124. See TEX. NAT. RES. § 102.011–.018 (West 2011) (creating a limited method of encouraging pooling by allowing small tract owners to muscle into a pooled unit); *Broussard v. Texaco, Inc.*, 479 S.W.2d 270, 276 (Tex. 1972) (noting the legislative intent of MIPA drafters to both protect small tracts and encourage mineral interest owners to pool on their own accord); see also Frank Douglass & H. Philip Whitworth, Jr., *Practice Before the Oil and Gas Division of the Railroad Commission of Texas*, 13 ST. MARY’S L.J. 719, 742–43 (1982) (providing a practical list of requirements to be satisfied by mineral interest owners before compulsory pooling).

MIPA is best described as a largely theoretical, but insignificant, aberration from the general Texas rule that an oil and gas leasehold interest holder seeking to pool tracts must obtain the voluntary consent of each mineral and royalty interest owner.<sup>125</sup>

As a practical matter, voluntary pooling can be accomplished through four main methods: (1) inclusion of an entireties clause in an oil and gas lease;<sup>126</sup> (2) execution of a separate pooling agreement or authorization;<sup>127</sup> (3) inclusion of a lease pooling clause;<sup>128</sup> or (4) execution of a community lease.<sup>129</sup> Of these four alternatives, the inclusion of an entireties clause within the lease is particularly problematic and the general trend amongst practitioners has been to abandon its use.<sup>130</sup>

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125. See *Am. Operating Co. v. R.R. Comm'n of Tex.*, 744 S.W.2d 149, 154 (Tex. App.—Houston [14th Dist.] 1987, writ denied) (“The purpose of the MIPA is to provide an incentive and an encouragement to voluntary pooling among parties.”); see also 3 ERNEST E. SMITH & JACQUELINE LANG WEAVER, *TEXAS LAW OF OIL AND GAS* § 12.1[B] (2d ed. 2012) (warning “the act is not a ‘cure-all’ because it is so limited in scope and effect” and the jurisdiction of the Railroad Commission on pooling is narrowly construed). It should be noted that consent to pooling is not required from non-participating royalty interest owners in what are referred to as non “drillsite” tracts.

126. See James E. Key, *The Right to Royalty: Pooling and the Capture of Unburdened Interests*, 17 TEX. WESLEYAN L. REV. 69, 74 (2010) (“An entirety clause typically provides that royalties will be paid based on the ownership of the entire leased premises, and not on who owns the land upon which the minerals are produced.” (citing *Thomas Gilcrease Found. v. Stanolind Oil & Gas Co.*, 153 Tex. 197, 266 S.W.2d 850, 851 (1954))); see also George A. Snell, III, *Pooling—From A to Horizontal*, E. TEX. ASS'N OF PETROL. LANDMEN, 4–5 (Spring 2011) (on file with the *St. Mary's Law Journal*) (stating division of royalties based on surface acreage may “lead to complex royalty calculations,” thus most current leases “do not include an entirety clause” (citing *Thomas Gilcrease Found.*, 266 S.W.2d at 851–53)).

127. See Jeffery L. Hart & J. Bruce Bennett, *Selected Pooling Issues*, in STATE BAR OF TEXAS, 27TH ANNUAL ADVANCED OIL, GAS AND ENERGY RESOURCES LAW COURSE 5 (Oct. 8–9, 2009) (detailing when a separate authorization form may be used); see also RICHARD L. MERRILL, *VOLUNTARY POOLING OF OIL AND GAS IN TEXAS* 6 (2010) (listing various types of separate agreements).

128. See 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, 225 (2009–2010) (noting the importance of the lease pooling clause in Texas). See generally JOHN S. LOWE, *OIL AND GAS LAW IN A NUTSHELL* 242–44 (5th ed. 2009) (describing the effect of a pooling clause on a lease).

129. See *Southland Royalty Co. v. Humble Oil & Ref. Co.*, 151 Tex. 324, 249 S.W.2d 914, 916 (1952) (listing the legal consequences of a community lease between the lessors); see also James E. Key, *The Right to Royalty: Pooling and the Capture of Unburdened Interests*, 17 TEX. WESLEYAN L. REV. 69, 73 (2010) (“In essence, a community lease is a single lease that covers two or more tracts executed by the separate landowners as if they were joint owners of the entire leased premises.”).

130. Though stated easily enough, historical practices such as the inclusion of entireties clauses have often added layers of complexity. See George A. Snell, III, *Pooling—From A to Horizontal*, E. TEX. ASS'N OF PETROL. LANDMEN, 4–5 (Spring 2011) (on file with the *St. Mary's Law Journal*) (discussing the difficulties of the entireties clause). For example, a legal relic of the past dictates that

Likewise, voluntary pooling by way of the community lease has largely fallen out of favor as well.<sup>131</sup> A community lease is a single lease document that covers two or more separately owned tracts of land.<sup>132</sup> By executing a community lease, the lessors are deemed to voluntarily accomplish the pooling of their interests in the various tracts by way of the lease, as if they were mutual owners.<sup>133</sup> As a legal consequence, each mineral owner surrenders the right to have the previously unencumbered tract independently developed.<sup>134</sup> Today, pure community leases involving multiple mineral owners are not frequently encountered as a method of voluntary pooling, except in “urban leasing situations involving homeowners and other associations seeking to lease small tracts in bulk to increase negotiating power.”<sup>135</sup>

More frequently—and particularly with regard to NPRIs—community leases can result where multiple royalty tracts are included in a single oil and gas lease.<sup>136</sup> For example, one large mineral tract may be internally subdivided by the presence of different royalty burdens on distinct portions thereof.<sup>137</sup> This form of community lease is largely created

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an entireties clause in an oil and gas lease divides the royalty amounts among all tracts, subject to the lease on a surface acreage basis, which invalidates the application of the nonapportionment rule. *See id.* at 4 (emphasizing that the entireties clause “negates the non[apportionment rule]”). Accordingly, royalties from all tracts covered by the lease are pooled amongst each other. *See id.* at 4–5 (clarifying that “all royalty owners . . . share proportionately in all royalty”); *see also* *Montgomery v. Rittersbacher*, 424 S.W.2d 210, 213 (Tex. 1968) (using the entireties clause to expand royalty shares across the entire lease without limiting the royalties to individual tracts). Complex and unanticipated royalty calculations resulting from the inclusion of tracts leased with an entireties clause with other lands in a pooled unit eventually led to the demise of this form of consensual pooling of interests. *See* George A. Snell, III, *Pooling—From A to Horizontal*, E. TEX. ASS'N OF PETROL. LANDMEN, 4–5 (Spring 2011) (on file with the *St. Mary's Law Journal*) (warning against the use of the entirety clause).

131. *See* James E. Key, *The Right to Royalty: Pooling and the Capture of Unburdened Interests*, 17 TEX. WESLEYAN L. REV. 69, 73 (2010) (noting community leases are uncommon); *see also* JOSEPH SHADE, PRIMER ON THE TEXAS LAW OF OIL AND GAS 124 (rev. 4th ed. 2012) (“The community lease is no longer commonly used as a means to voluntarily pool.”).

132. ALOYSIUS A. LEOPOLD, LAND TITLES AND TITLE EXAMINATION § 23.28 (3d ed. 2005).

133. *See* *Ruiz v. Martin*, 559 S.W.2d 839, 843–44 (Tex. Civ. App.—San Antonio 1977, writ ref'd n.r.e.) (determining the ratification of the community lease effectively pooled the royalty interests); *Parker v. Parker*, 144 S.W.2d 303, 305 (Tex. Civ. App.—Galveston 1940, writ ref'd) (stating a community lease “empowered the lessee to treat the tract of land as subject to a common ownership”).

134. *Southland Royalty Co.*, 249 S.W.2d at 916.

135. James E. Key, *The Right to Royalty: Pooling and the Capture of Unburdened Interests*, 17 TEX. WESLEYAN L. REV. 69, 73 (2010).

136. *See, e.g., Southland Royalty Co.*, 249 S.W.2d at 915–16 (combining two separate tracts of land under a single community lease).

137. *See, e.g., id.* at 914–15 (finding various royalty obligations on the combined tract of land where different sections within the tract were initially subject to divergent obligations, including one-half interest and one-thirty-second interests).

unintentionally, particularly when a competitive leasing environment results in the execution of leases on large tracts of land before a full title search reveals differing royalty burdens.<sup>138</sup> In the case of a mineral tract with distinct internal royalty burdens, the executive is deemed to have made an implied offer to the NPRI owner to pool all leased tracts.<sup>139</sup> The NPRI owner may then accept or reject this implied offer, depending upon the potential benefits.<sup>140</sup>

Today, most voluntary pooling occurs pursuant to the pooling clause within an oil and gas lease.<sup>141</sup> With the limited exception of MIPA, the pooling of oil and gas interests necessitates consent from those pooled.<sup>142</sup> The principal effect of a pooling clause is to serve as an express grant of authority from the mineral owner/lessor to the lessee, allowing the lessee to pool the lessor's interest within the parameters set forth in the lease.<sup>143</sup> Essentially, the lessor allows the lessee to combine the lessor's interest with other mineral interests from nearby or adjacent tracts in order to form a single drilling unit on which to drill a well, the production from this unit will be shared on a pro rata basis with all validly pooled interest owners.<sup>144</sup>

The pooling powers granted by such clauses are generally anticipatory and broad.<sup>145</sup> Critical to the requirement of consent to pooling is the

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138. *Cf. Southland Royalty Co.*, 249 S.W.2d at 915–16 (noting the differing royalty burdens on the tracts pooled under the community lease); *French v. George*, 159 S.W.2d 566, 567–68 (Tex. Civ. App.—Amarillo 1942, writ ref'd) (listing the numerous defendants contesting the interpretation of the community lease and subsequent royalty payments).

139. *See Ruiz v. Martin*, 559 S.W.2d 839, 843 (Tex. Civ. App.—San Antonio 1977, writ ref'd n.r.e.) (“The lease amounted to a proposal or offer . . .”); *see also Montgomery v. Rittersbacher*, 424 S.W.2d 210, 213–14 (Tex. 1968) (establishing that the lease implied an offer to the non-executives).

140. *See Montgomery*, 424 S.W.2d at 215 (holding a “non-participating royalty owner has the option to ratify or repudiate a lease”); *Ruiz*, 559 S.W.2d at 843–44 (finding ratification by the nonparticipatory royalty owners implied consent to the offer to pool).

141. 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, 225 (2009–2010).

142. RICHARD L. MERRILL, VOLUNTARY POOLING OF OIL AND GAS IN TEXAS 4 (2010); *see also Se. Pipe Line Co. v. Tichacek*, 997 S.W.2d 166, 170 (Tex. 1999) (noting a lessee must obtain authorization to pool).

143. *See* 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, 225–26 (2009–2010) (outlining the consequences of pooling without the consent of a lessor or outside the terms set forth in the lease).

144. *See* 1 PATRICK H. MARTIN & BRUCE M. KRAMER, WILLIAMS & MEYERS OIL AND GAS LAW § 961.2 (abridged 3d ed. 2007) (explaining how royalties are divided amongst pooled owners); George A. Snell, III, *Pooling—From A to Horizontal*, E. TEX. ASS'N OF PETROL. LANDMEN, 4 (Spring 2011) (on file with the *St. Mary's Law Journal*) (describing the contents of a typical pooling clause).

145. *See Sabre Oil & Gas Corp. v. Gibson*, 72 S.W.3d 812, 816 (Tex. App.—Eastland 2002, pet. denied) (specifying that unless the language provides otherwise, the pooling clause “should not be

Texas view that a grant of pooling authority, when exercised, is considered a cross-conveyance of interests amongst the relevant interest owners.<sup>146</sup> Because the lessor is in effect appointing the lessee as an agent in making such pooling decisions, courts generally construe pooling clauses strictly against the lessee.<sup>147</sup> Note, however, that the Texas Supreme Court recently revisited this issue in *Wagner & Brown, Ltd. v. Sheppard*,<sup>148</sup> interpreting a pooling clause in a broad sense and favorably to the lessee, which may represent a shift in the court's level of scrutiny.<sup>149</sup>

Pooling may also be accomplished by a separate agreement altogether.<sup>150</sup> The reasons why an operator would secure a separate pooling agreement are myriad, but generally fall within the following categories: (1) an attempt to more effectively develop the leased acreage through a larger acreage unit than allowed in the lease;<sup>151</sup> (2) a desire to replace previous bans on pooling;<sup>152</sup> or (3) an effort to acquire

construed in a narrow or limited sense"); *Elliot v. Davis*, 553 S.W.2d 223, 226 (Tex. Civ. App.—Amarillo 1977, writ ref'd n.r.e.) (citing *Tiller v. Fields*, 301 S.W.2d 185, 190 (Tex. Civ. App.—Texarkana 1957, no writ) (describing the pooling power as anticipatory and broad)); *see also* George A. Snell, III, *Pooling—From A to Horizontal*, E. TEX. ASS'N OF PETROL. LANDMEN, 4 (Spring 2011) (on file with the *St. Mary's Law Journal*) (reiterating the broad applicability of the lease pooling power).

146. *See* *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 634 (Tex. App.—Austin 2000, pet. denied) (clarifying pooling creates “a cross-conveyance of interests in land” (quoting *MCZ, Inc. v. Triolo*, 708 S.W.2d 49, 52–53 (Tex. App.—Houston [1st Dist.] 1986, writ ref'd n.r.e.)); *see also* *Se. Pipe Line Co.*, 997 S.W.2d at 170 (requiring consent of lessor to pool).

147. *See* *Jones v. Killingsworth*, 403 S.W.2d 325, 328 (Tex. 1965) (ascertaining the intent of the parties and construing the lease against the lessee); *see also* George A. Snell, III, *Pooling—From A to Horizontal*, E. TEX. ASS'N OF PETROL. LANDMEN, 4 (Spring 2011) (on file with the *St. Mary's Law Journal*) (opining that courts interpret pooling clauses against the lessee as they have greater bargaining power as against the lessor (citing *Jones*, 403 S.W.2d at 327–28)).

148. *Wagner & Brown, Ltd. v. Sheppard*, 282 S.W.3d 419 (Tex. 2008).

149. *See id.* at 430 (holding the termination of a lease does not end royalty owner participation in the pooled unit); 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, 262 (2009–2010) (“[A]lthough *Sheppard* joins a long line of cases in which the Texas Supreme Court has adopted producers’ legal arguments in oil and gas lease disputes, it injects unprecedented uncertainty into Texas oil and gas jurisprudence.”). *But see* *Jones*, 403 S.W.2d at 328 (limiting lessee’s pooling powers to those expressly in the lease and favoring the lessor in lease disputes).

150. *See* Jeffery L. Hart & J. Bruce Bennett, *Selected Pooling Issues*, in STATE BAR OF TEXAS, 27TH ANNUAL ADVANCED OIL, GAS AND ENERGY RESOURCES LAW COURSE 5 (Oct. 8–9, 2009) (opining “a separate pooling authorization will be required” absent a pooling clause in an oil and gas lease); *see also* RICHARD L. MERRILL, VOLUNTARY POOLING OF OIL AND GAS IN TEXAS 6 (2010) (listing the other types of separate agreements, including “(i) the pooling designation or declaration; (ii) a ratification of pooling; or (iii) an amendment of the lease to allow the pooling”).

151. *See, e.g., Luecke*, 38 S.W.3d at 638 (describing the “Certificate of Pooling Authority” used to expand drilling to the greatest acreage possible).

152. Leases held by production from decades before may not have contemplated modern production techniques, which necessitate the pooling of tracts. *See id.* (realizing the parties to the lease “did not contemplate the possibility” of future technological developments).

authorization from royalty owners who do not possess executive rights, yet whom do not wish to consent to the broad pooling authority in a given lease.<sup>153</sup>

When the pooling power is exercised, regardless of the manner in which it was achieved, operators combine several tracts to form a single pooled unit; it is as if the pooled unit is one single tract with several fractional interest owners.<sup>154</sup> Thus, operations and production anywhere within the unit will be considered to have occurred upon all lands within the unit.<sup>155</sup> Therefore, once pooled, the royalty interest owners cease to own the full, undivided interest underneath their respective tracts for the duration of the pooling.<sup>156</sup> Instead, they own undivided interests in the production obtained from the entire pooled unit.<sup>157</sup>

The legal effect of this consent to pool is the same as a conveyance.<sup>158</sup> When royalty interest owners consent to pooling, they have effectively executed a cross-conveyance of their interests amongst themselves within the confines of the pooled acreage, thus yielding an undivided interest in the production resulting from the entire pooled unit, regardless of where the well is physically located.<sup>159</sup> The size of this resulting royalty interest is determined on a pro rata basis according to each interest's proportionate

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153. See RICHARD L. MERRILL, VOLUNTARY POOLING OF OIL AND GAS IN TEXAS 6 (2010) (maintaining non-participating royalty owners must give consent to pool); see also Jeffery L. Hart & J. Bruce Bennett, *Selected Pooling Issues*, in STATE BAR OF TEXAS, 27TH ANNUAL ADVANCED OIL, GAS AND ENERGY RESOURCES LAW COURSE 5 (Oct. 8–9, 2009) (“A separate [pooling] authorization is also required if there are outstanding royalty interests that are owned by persons other than the executive rights lessors who sign the lease.”).

154. See *Luecke*, 38 S.W.3d at 634 (describing the functionality of pooling).

155. *Id.* (citing *Southland Royalty Co. v. Humble Oil & Ref. Co.*, 151 Tex. 324, 249 S.W.2d 914, 916 (1952)).

156. See *id.* (describing the royalty interest owner status after pooling).

157. See *id.* (“With regard to the royalty interest owners, pooling results in . . . ‘an undivided joint ownership in the royalty earned from the land in the “block” created by the agreement.’” (quoting *MCZ, Inc. v. Triolo*, 708 S.W.2d 49, 52–53 (Tex. App.—Houston [1st Dist.] 1986, writ ref’d n.r.e.)); RICHARD L. MERRILL, VOLUNTARY POOLING OF OIL AND GAS IN TEXAS 4 (2010) (recognizing a royalty owner’s individual contribution to the unit determines their proportionate share of the pooled unit (citing *PYR Energy Corp. v. Samson Res. Co.*, 456 F. Supp. 2d 786, 791–92 (E.D. Tex. 2006)); accord *Veal v. Thomason*, 138 Tex. 341, 159 S.W.2d 472, 476 (1942) (finding the lease stated royalty owners shall share on a proportionate basis within the pooled unit), *superseded by statute on other grounds as recognized by Kodiak Res., Inc. v. Smith*, 361 S.W.3d 246, 249–50 (Tex. App.—Beaumont 2012, no pet.).

158. See *Montgomery v. Rittersbacher*, 424 S.W.2d 210, 213 (Tex. 1968) (reiterating pooling results in a “cross-conveyance among the owners of minerals” (citing *Veal*, 159 S.W.2d at 476)).

159. See RICHARD L. MERRILL, VOLUNTARY POOLING OF OIL AND GAS IN TEXAS 4 (2010) (noting royalty owners own a proportionate share of the pooled unit in relation to their individual contributions to the unit (citing *PYR Energy Corp.*, 456 F. Supp. 2d at 791–92)).

tract acreage within the pooled unit as a whole.<sup>160</sup>

Because pooling is a cross-conveyance of interests, which has the ability to dilute or lessen the interest of the NPRI owner,<sup>161</sup> the executive cannot bind the NPRI through pooling.<sup>162</sup> In effect, an NPRI owner must him or herself consent to a cross-conveyance of their interests.<sup>163</sup>

Compared to a number of jurisdictions, Texas is unusual in its application of the cross-conveyance theory of pooling.<sup>164</sup> Traditionally, two competing theories have been applied to the effect of pooling: Pooling as a cross-conveyance of interests,<sup>165</sup> or as a matter of contract.<sup>166</sup> As previously noted, the basis for the cross-conveyance theory is the premise that mineral interests involved in the pooled unit are actually conveyed to other owners within the pooled unit in proportion to the acreage allocated by each to the unit.<sup>167</sup>

On the other hand, the contract basis for pooling stipulates that property interests themselves are not conveyed; rather, this approach seeks to determine the contractual rights associated with royalty payments.<sup>168</sup> A split exists amongst the states regarding which theory is applicable.<sup>169</sup> In

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160. See *Luecke*, 38 S.W.3d at 634 (“Royalty is distributed on the basis of the proportion each party’s acreage bears to the whole block.” (quoting *MCZ, Inc.*, 708 S.W.2d at 52–53)); see also *Brown v. Smith*, 141 Tex. 425, 174 S.W.2d 43, 46 (1943) (sharing the royalties based on each owner’s proportional acreage).

161. See *Montgomery*, 424 S.W.2d at 213 (explaining pooling causes all undivided interest owners to share their respective royalties proportionate to one another, effectively diluting their interests).

162. *Id.*; *Smith*, 174 S.W.2d at 46; *Nugent v. Freeman*, 306 S.W.2d 167, 170 (Tex. Civ. App.—Eastland 1957, writ re’f’d n.r.e.).

163. See *id.* (reasoning a lease does not pool an NPRI absent explicit consent); *Smith*, 174 S.W.2d at 46 (emphasizing the lease did not affect the NPRI’s ownership interest); *Brown v. Getty Reserve Oil, Inc.*, 626 S.W.2d 810, 814 (Tex. App.—Amarillo 1981, writ dismissed) (finding executive interest owners cannot unilaterally bind NPRI owners); *Nugent*, 306 S.W.2d at 170 (finding there was no authority to pool without consent).

164. Compare *Montgomery*, 424 S.W.2d at 213 (declaring that pooling is a cross-conveyance), with *Hover v. Cleveland Oil Co.*, 95 P.2d 264, 266 (Kan. 1939) (holding that a seller of land retained no interest in royalties of pool), and *Sinclair Crude Oil Co. v. Okla. Tax Comm’n*, 326 P.2d 1051, 1055 (Okla. 1958) (stating that a pooling agreement did not convey an interest in land).

165. See Gary B. Conine, *Property Provisions of the Operating Agreement—Interpretation, Validity, and Enforceability*, 19 TEX. TECH L. REV. 1263, 1279–80 (1988) (contrasting contract and cross-conveyance theories).

166. See *id.* (noting the vast majority of jurisdictions follow this theory).

167. See *Montgomery*, 424 S.W.2d at 213 (describing the effect of a mineral owner pooling).

168. Mitchell E. Ayer & Jonathan D. Baughman, *Navigating the Pooling Clause Waters: New and Recurring Issues*, 53 ROCKY MTN. MIN. L. INST. § 33.05[5] (2007).

169. See Gary B. Conine, *Property Provisions of the Operating Agreement—Interpretation, Validity, and Enforceability*, 19 TEX. TECH L. REV. 1263, 1279–80 (1988) (observing the disagreement among states). States employing the contract theory include Utah, Oklahoma, Kansas, and West Virginia. Mitchell E. Ayer & Jonathan D. Baughman, *Navigating the Pooling Clause Waters: New and Recurring*

the 1942 case of *Veal v. Thomason*,<sup>170</sup> the Texas Supreme Court took a firm stance in determining that pooling constitutes a cross-conveyance of interests.<sup>171</sup> The court held that the theoretical cross-conveyance basis for pooling applied to community leases.<sup>172</sup> This ruling was expanded in 1968 when the Texas Supreme Court decided *Montgomery v. Rittersbacher*,<sup>173</sup> and applied the cross-conveyance theory to NPRI owners.<sup>174</sup> Citing *Veal*, the *Montgomery* court found “that pooling effects a cross-conveyance among the owners of minerals under the various tracts of royalty or minerals in a pool so that they all own undivided interests under the unitized tract in the proportion their contribution bears to the unitized tract.”<sup>175</sup> This cross-conveyance theory remains applicable today,<sup>176</sup> and is the impetus behind the rule that NPRI owners must consent to the pooling of their interest.<sup>177</sup> However, *Veal* and *Montgomery* were decided when oil and gas exploration technology was almost exclusively limited to producing hydrocarbons from vertical wells.<sup>178</sup>

After consent to pooling is granted, the lessee has the sole discretion, pursuant to the terms and limitations of the lease or pooling agreement, to decide where and how to pool.<sup>179</sup> These broad powers afford the lessee to control significantly which tracts share in production from a pooled

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*Issues*, 53 ROCKY MTN. MIN. L. INST. § 33.05[5] (2007). Those states adopting the cross-conveyance theory include Mississippi, Texas, Illinois, and California. *Id.*

170. *Veal v. Thomason*, 138 Tex. 341, 159 S.W.2d 472 (1942), *superseded by statute on other grounds as recognized by* *Kodiak Res., Inc. v. Smith*, 361 S.W.3d 246, 249–50 (Tex. App.—Beaumont 2012, no pet.).

171. *See id.* at 476 (establishing that a unitization agreement is a conveyance resulting in joint ownership on a pro rata basis). For purposes of describing a cross-conveyance, the terms unitization and pooling are interchangeable. *London v. Merriman*, 756 S.W.2d 736, 739 n.1 (Tex. App.—Corpus Christi 1988, writ denied).

172. *See Veal*, 159 S.W.2d at 475–76 (holding that the lessors pooled their interests and in doing so became joint owners).

173. *Montgomery v. Rittersbacher*, 424 S.W.2d 210 (Tex. 1968).

174. *Id.* at 213 (citing *Veal*, 159 S.W.2d at 476).

175. *Id.*

176. *See, e.g.,* *MCEN 1996 P’ship v. Glassell*, 42 S.W.3d 262, 263 (Tex. App.—Corpus Christi 2001, pet. denied) (stating that pooling results in a conveyance).

177. *See Montgomery*, 424 S.W.2d at 213 (finding consent of the owner indispensable when a pooling clause “has the effect of changing the aggregate ownership of the non-participating royalty owner”).

178. *See generally* Christy M. Schweikhardt, Note, *Horizontal Perspective: Texas Oil & Gas Law in Light of Horizontal Drilling Technology*, 34 S. TEX. L. REV. 329, 329–30 (1993) (noting that horizontal drilling did not expand until the 1980s).

179. *See Jones v. Killingsworth*, 403 S.W.2d 325, 327 (Tex. 1965) (finding the lease agreement authorized the lessee to pool but that the manner in which he pooled was not authorized).

unit.<sup>180</sup> Accordingly, some courts have incorporated concepts of fiduciaries and the strictures of agency to the relationship between the lessee and consenting royalty owners.<sup>181</sup> Though the duties of parties to an oil and gas lease is a topic well beyond the scope of this paper, some Texas courts suggest that lessees act as agents for the lessors when making the appropriate cross-conveyance of interests.<sup>182</sup> Consequently, lessees must act within the powers granted by the pooling clause and strictly adhere to the express terms of the lease.<sup>183</sup> Furthermore, lessees are required to act in good faith in deciding whether to pool, as well as in the manner in which pooling is conducted.<sup>184</sup>

### III. NATURE AND ATTRIBUTES OF NPRI: THE RELATIONSHIP BETWEEN NPRI, NON-EXECUTIVE MINERAL COTENANTS, AND EXECUTIVE RIGHT HOLDERS

An NPRI is the right, purchased from or reserved by a mineral owner, to be paid a specified fraction of gross production if and when oil or gas is produced.<sup>185</sup> The NPRI owner is not an essential participant “to a lease of the mineral estate but rather only is entitled to an interest in ‘actual

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180. *See, e.g.*, *London v. Merriman*, 756 S.W.2d 736, 739 (Tex. App.—Corpus Christi 1988, writ denied) (stating royalties would be allocated on a pro rata basis if the lessor exercised his or her discretion to pool).

181. *See Expando Prod. Co. v. Marshall*, 407 S.W.2d 254, 260 (Tex. Civ. App.—Fort Worth 1966, writ ref'd n.r.e.) (finding a fiduciary duty of good faith towards the lessor under the power granted by the pooling agreement); *Tiller v. Fields*, 301 S.W.2d 185, 188–89 (Tex. Civ. App.—Texarkana 1957, no writ) (analogizing to agency law to describe the relationship between lessee and lessor). *But see* 1 ERNEST E. SMITH & JACQUELINE LANG WEAVER, TEXAS LAW OF OIL AND GAS § 4.8[C][1] (2d ed. 2012) (cautioning against the use of agency language as it is potentially misleading).

182. *See Yelderman v. McCarthy*, 474 S.W.2d 781, 784 (Tex. Civ. App.—Houston [1st Dist.] 1971, writ ref'd n.r.e.) (classifying the lessee as an agent of lessors); *Tiller*, 301 S.W.2d at 189–90 (concluding, after reviewing cases describing the duties of the lessee in agency terms, that the lessee is subject to an implied requirement to act in good faith, without explicitly labeling it an agency relationship).

183. *See, e.g., Yelderman*, 474 S.W.2d at 784 (specifying that the lessee must abide by the lease terms).

184. *See Circle Dot Ranch, Inc. v. Sidwell Oil and Gas, Inc.*, 891 S.W.2d 342, 345 (Tex. App.—Amarillo 1995, writ denied) (claiming that a lessee's decision to pool is subject to a good faith standard (citing *Vela v. Pennzoil Producing Co.*, 723 S.W.2d 199, 206 (Tex. App.—San Antonio 1986, writ ref'd n.r.e.)); 1 ERNEST E. SMITH & JACQUELINE LANG WEAVER, TEXAS LAW OF OIL AND GAS § 4.8[C] (2d ed. 2012) (discussing the exercise of the pooling provision).

185. *See Plainsman Trading Co. v. Crews*, 898 S.W.2d 786, 789 (Tex. 1995) (“[An NPRI is] *non-possessory* in that it does not entitle its owner to produce the minerals . . . . It merely entitles its owner to a share of the production proceeds, free of the expenses of exploration and production.”); *see also* Lee Jones, Jr., *Non-Participating Royalty*, 26 TEX. L. REV. 569, 569 (1948) (discussing the non-participating royalty).

production' once the minerals are severed."<sup>186</sup> By definition, the NPRI owner lacks all incidents of the executive mineral owner, having no power to negotiate and execute oil and gas leases, no right to bonus payments or delay rentals, and certainly no power to enter upon the land to develop the mineral estate.<sup>187</sup> In the words of noted oil and gas attorney Allen D. Cummings, the NPRI "is an interest in land that depends upon the kindness of strangers."<sup>188</sup> Because "[a] purchaser of a non[-]participating royalty interest contemplates receiving royalty from production, however, accrual of such royalty is completely dependent upon the actions of the holder of the executive rights . . . ."<sup>189</sup> The NPRI holder may find that such kindness is contingent upon an increasingly stringent set of duties owed by the executive rights owner.<sup>190</sup>

An NPRI may be granted<sup>191</sup> or reserved<sup>192</sup> before or after a oil and gas agreement is executed.<sup>193</sup> An NPRI is a nonpossessory interest, which means that the NPRI owner does not own the minerals in place but instead holds only a presently vested right to a stated fraction of production from any and all minerals produced.<sup>194</sup> As stated by the Texas

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186. Christopher Kulander, *Big Money vs. Grand Designs: Revisiting the Executive Right to Lease Oil & Gas Interests*, 42 TEX. TECH L. REV. 33, 66 (2009).

187. See *Plainsman Trading Co.*, 898 S.W.2d at 789 (noting the well-established definition of an NPRI, which excludes rights to participate in execution of the lease or to receive bonuses thereon (citing Lee Jones, Jr., *Non-Participating Royalty*, 26 TEX. L. REV. 569, 569 (1948))); see also *Arnold v. Ashbel Smith Land Co.*, 307 S.W.2d 818, 825 (Tex. Civ. App.—Galveston 1957, writ ref'd n.r.e.) (explaining the limitations of a non-participating royalty); 1 ERNEST E. SMITH & JACQUELINE LANG WEAVER, TEXAS LAW OF OIL & GAS § 2.4[B][2] (2d ed. 2012) (examining the NPRI). See generally Lee Jones, Jr., *Non-Participating Royalty*, 26 TEX. L. REV. 569, 569 (1948) (exploring the traits of the NPRI). "[R]oyalty [not necessarily just an NPRI] has a specific meaning in oil and gas law that does not include bonuses and rental payments." *In re Bass*, 113 S.W.3d 735, 744 (Tex. 2003) (orig. proceeding) (citing *Schlittler v. Smith*, 128 Tex. 628, 101 S.W.2d 543, 544 (1937)).

188. Allen D. Cummings, *Pooling and Community Leases: Problems and Options for the Executive Owner, the Non-Executive Owner and the Lessee*, in STATE BAR OF TEXAS 15TH ANNUAL ADVANCED OIL, GAS AND MINERAL LAW COURSE, at I-1, I-2 (1997).

189. *Id.*

190. See generally *id.* (giving an example of how a person with the executive right can affect the NPRI owner and the protections given to the NPRI owner).

191. Lee Jones, Jr., *Non-Participating Royalty*, 26 TEX. L. REV. 569, 569 (1948); see *White v. White*, 830 S.W.2d 767, 768 (Tex. App.—Houston [1st Dist.] 1992, writ denied) (handling an NPRI created by grant).

192. Lee Jones, Jr., *Non-Participating Royalty*, 26 TEX. L. REV. 569, 569 (1948); see *In re Bass*, 113 S.W.3d at 738 (dealing with a reservation of an NPRI).

193. See Lee Jones, Jr., *Non-Participating Royalty*, 26 TEX. L. REV. 569, 569 (1948) (explaining how and when an NPRI can come into existence).

194. See *Plainsman Trading Co. v. Crews*, 898 S.W.2d 786, 789 (Tex. 1995) ("A non-participating royalty interest, however, is *non-possessory* in that it does not entitle its owner to produce the minerals himself. It merely entitles its owner to a share of the production proceeds, free of the

Supreme Court, “[W]hen a grantor reserves to himself a royalty interest[,] he contemplates the leasing of the land for production, and that if he reserves to himself no right of leasing, the grantee possesses that right.”<sup>195</sup>

A. *Importance of Consent from NPRI Owners When Pooling Interests*

There is one glaring caveat to the non-executive nature of an NPRI. While Texas law clearly states that the holder of the executive right has the authority to bind non-participating interests to most lease provisions,<sup>196</sup> courts consistently hold that “pooling on the part of the holder of the executive rights cannot be binding upon the non-participating royalty owner in the absence of his consent.”<sup>197</sup> While the executive rights holder has the authority to negotiate the lease royalty and all other dispositive terms of the oil and gas lease,<sup>198</sup> the executive lacks the authority to pool the NPRI with other tracts in a manner that would dilute the fractional royalty interest of the NPRI owner as to production from under his or her tract.<sup>199</sup> This is according to the Texas view that pooling amounts to a cross-conveyance of the NPRI owner’s interest in the absence of his or her consent.<sup>200</sup> If an NPRI is to share in the proceeds of production from a pooled unit on a pro rata basis with all other interest owners, the NPRI owner must consent to the participation of his or her

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expenses of exploration and production.” (alteration in original) (citing *Arnold v. Ashbel Smith Land Co.*, 307 S.W.2d 818, 825 (Tex. Civ. App.—Galveston 1957, writ re’fd n.r.e.)).

195. *Brown v. Smith*, 141 Tex. 425, 174 S.W.2d 43, 46 (1943).

196. *Manges v. Guerra*, 673 S.W.2d 180, 183 (Tex. 1984) (citations omitted); *Montgomery v. Rittersbacher*, 424 S.W.2d 210, 212–13 (Tex. 1968); James E. Key, *The Right to Royalty: Pooling and the Capture of Unburdened Interests*, 17 TEX. WESLEYAN L. REV. 69, 75 (2010).

197. *Montgomery*, 424 S.W.2d at 213 (citing *Minchen v. Fields*, 162 Tex. 73, 345 S.W.2d 282, 285 (1961)); *Smith*, 174 S.W.2d at 46; *Nugent v. Freeman*, 306 S.W.2d 167, 170 (Tex. Civ. App.—Eastland 1957, writ re’fd n.r.e.); James E. Key, *The Right to Royalty: Pooling and the Capture of Unburdened Interests*, 17 TEX. WESLEYAN L. REV. 69, 75 (2010).

198. Patrick H. Martin, *Unbundling the Executive Right: A Guide to Interpretation of the Power to Lease and Develop Oil and Gas Interests*, 37 NAT. RESOURCES J. 311, 315–16 & n.15 (1997).

199. *Montgomery*, 424 S.W.2d at 212; see *Smith*, 174 S.W.2d at 46 (holding the executive right holder could not unilaterally bind a non-participating royalty interest to a lease pooling clause (citing *Gulf Oil Corp. v. Marathon Oil Co.*, 137 Tex. 59, 152 S.W.2d 711, 724 (1941))); James E. Key, *The Right to Royalty: Pooling and the Capture of Unburdened Interests*, 17 TEX. WESLEYAN L. REV. 69, 75 (2010) (clarifying that the reservation of an NPRI does not indicate the intent to allow the executive right holder the power to dilute the NPRI owner’s interest).

200. James E. Key, *The Right to Royalty: Pooling and the Capture of Unburdened Interests*, 17 TEX. WESLEYAN L. REV. 69, 75 (2010); see *Smith*, 174 S.W.2d at 46 (indicating the pooling of land under an oil and gas lease represents a “conveyance by each lessor to each of the other lessors of an undivided interests in the royalties” and would not support an inclusion of an NPRI without the owner’s consent) (citations omitted).

interest.<sup>201</sup>

The most common way to obtain the NPRI owner's consent to pool under a lease executed by the executive is to have the NPRI owner ratify the lease in question.<sup>202</sup> Ratification is defined as "the adoption or confirmation by a person, with knowledge of all material facts, of a prior act which did not then legally bind that person and which that person had the right to repudiate."<sup>203</sup> "Ratification extends to all aspects of a transaction, but does not reach beyond the one transaction."<sup>204</sup> Consequently, "[r]atification has the effect of prior authority."<sup>205</sup> Recognizing the far-reaching consequences of a blanket ratification of an oil and gas lease<sup>206</sup> and spurred on by Texas court rulings allowing for selective ratification of lessee actions,<sup>207</sup> sophisticated NPRI owners increasingly opt for pooling agreements or other limited forms of authorization relating to the executive's unauthorized acts of pooling.<sup>208</sup>

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201. *Montgomery*, 424 S.W.2d at 215; *Ruiz v. Martin*, 559 S.W.2d 839, 844 (Tex. Civ. App.—San Antonio 1977, writ ref'd n.r.e.) (quoting *Standard Oil Co. of Tex. v. Donald*, 321 S.W.2d 602, 605 (Tex. Civ. App.—Fort Worth 1959, writ ref'd n.r.e.)); James E. Key, *The Right to Royalty: Pooling and the Capture of Unburdened Interests*, 17 TEX. WESLEYAN L. REV. 69, 77 (2010).

202. See James E. Key, *The Right to Royalty: Pooling and the Capture of Unburdened Interests*, 17 TEX. WESLEYAN L. REV. 69, 81 (2010) (calling ratification "the key that unlocks the royalty door for non-executive interest owners").

203. *Id.* (citing *Vessels v. Anschutz Corp.*, 823 S.W.2d 762, 764 (Tex. App.—Texarkana 1992, writ denied); *Kunkel v. Kunkel*, 515 S.W.2d 941, 948 (Tex. Civ. App.—Amarillo 1974, writ ref'd n.r.e.)).

204. *MCZ, Inc. v. Triolo*, 708 S.W.2d 49, 53–54 (Tex. App.—Houston [1st Dist.] 1986, writ ref'd n.r.e.).

205. *Yelderman v. McCarthy*, 474 S.W.2d 781, 784 (Tex. Civ. App.—Houston [1st Dist.] 1971, writ ref'd n.r.e.) (citing *Tex. Pac. Coal & Oil Co. v. Smith*, 130 S.W.2d 425, 430 (Tex. Civ. App.—Eastland 1939, writ dismissed judgment corrected)); *Murray Co. v. Dobbs*, 56 S.W.2d 233, 235 (Tex. Civ. App.—Amarillo 1933, no writ); James E. Key, *The Right to Royalty: Pooling and the Capture of Unburdened Interests*, 17 TEX. WESLEYAN L. REV. 69, 81 (2010) ("In other words, where ratification is applicable, the effect is the same as execution of the original lease." (citing *Ruiz*, 559 S.W.2d at 844)).

206. Allen D. Cummings, *Pooling and Community Leases: Problems and Options for the Executive Owner, the Non-Executive Owner and the Lessee*, in STATE BAR OF TEXAS, 15TH ANNUAL ADVANCED OIL, GAS AND MINERAL LAW COURSE, at I-1, I-30–31 (1997).

207. See, e.g., *MCZ, Inc.*, 708 S.W.2d at 53–54 (allowing selective ratification of lessee's actions where it benefited the NPRI owner, but recognizing the right of the NPRI to withhold consent to authorization of those actions that were detrimental to the NPRI owner). The *MCZ* court rejected the argument that ratification of one unauthorized act of pooling amounted to ratification of all unauthorized acts of pooling. *Id.* at 53–54.

208. Allen D. Cummings, *Pooling and Community Leases: Problems and Options for the Executive Owner, the Non-Executive Owner and the Lessee*, in STATE BAR OF TEXAS, 15TH ANNUAL ADVANCED OIL, GAS AND MINERAL LAW COURSE, at I-1, I-30–31 (1997).

B. *The Power of Consent: NPRI Owners Hold Great Power*

As discussed above, absent consent or agreement, no NPRI can be pooled.<sup>209</sup> In Texas, an NPRI is an independent interest that is not constrained by a pooling clause in a lease (that the holder of the NPRI did not execute).<sup>210</sup> The scope of the rule is questionable regarding horizontally drilled wells that penetrate multiple tracts. However, for those NPRI owners included in vertically developed pooled units, a non-consenting NPRI owner is entitled to insist upon a full fractional share of the production from the well bore located on his or her tract, not proportionately reduced by the presence of other purportedly pooled tracts.<sup>211</sup>

This independent interest places the NPRI owner in an enormously powerful bargaining position, and Texas courts have tended to expand that power.<sup>212</sup> This expanded power is applied uniformly, leading to the clear conclusion that “the NPRI [owner] currently enjoys a preferential status which . . . courts believe worthy of protection.”<sup>213</sup>

Unfortunately, alongside this rise in power of the NPRI,<sup>214</sup> reliance has greatly increased upon pooling as a means of assembling sufficient acreage

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209. Jeffery L. Hart & J. Bruce Bennett, *Selected Pooling Issues*, in STATE BAR OF TEXAS, 27TH ANNUAL ADVANCED OIL, GAS AND ENERGY RESOURCES LAW COURSE 13 (Oct. 8–9, 2009); see also *Guar. Nat'l Bank & Trust of Corpus Christi v. May*, 395 S.W.2d 80, 82 (Tex. Civ. App.—Waco 1965, writ ref'd n.r.e.) (requiring all interest owners' ratification of an agreement before pooling can occur).

210. See *Montgomery v. Rittersbacher*, 424 S.W.2d 210, 215 (Tex. 1968) (determining that for pooling applications, an NPRI owner is not bound by the provisions of a lease unless he or she ratifies it by either “joining in the execution . . . or by accepting royalties from the pool” (citing *Minchen v. Fields*, 162 Tex. 73, 345 S.W.2d 282, 285 (1961); *May*, 395 S.W.2d at 82; *Nugent v. Freeman*, 306 S.W.2d 167, 170 (Tex. Civ. App.—Eastland 1957, writ ref'd n.r.e.))).

211. See *MCZ, Inc.*, 708 S.W.2d at 53 (declaring an NPRI owner is entitled to full royalty from an interest not properly pooled or ratified); Allen D. Cummings, *Pooling and Community Leases: Problems and Options for the Executive Owner, the Non-Executive Owner and the Lessee*, in STATE BAR OF TEXAS, 15TH ANNUAL ADVANCED OIL, GAS AND MINERAL LAW COURSE at I-1, I-30 (1997) (indicating the advantage of an NPRI owner not ratifying a lease, for which a well is located on the burdened land, is that he or she is entitled to a full, undiluted royalty from production).

212. E.g., *Montgomery*, 424 S.W.2d at 215 (expanding the ability of an NPRI holder to either ratify or repudiate a provision of a lease).

213. George A. Snell, III, *Non-Consenting Mineral Interests*, DALLAS ASS'N OF PROF'L LANDMEN, 20 (Sept. 10, 2007) (on file with the *St. Mary's Law Journal*).

214. Compare *Montgomery*, 424 S.W.2d at 215 (allowing NPRI owner to ratify lease, entitling owner to proportion of production from pooled unit, but binding NPRI to full authority of all leasing provisions), with *MCZ, Inc.*, 708 S.W.2d at 53–54 (permitting an NPRI owner to ratify a pooling provision for one pool and reject provision for a second pool, thus allowing the collection of proportional royalties from the former pool and full royalties from the latter pool).

to develop wells utilizing horizontal drilling.<sup>215</sup> Accordingly, as greater amounts of acreage are pooled together, there is an increased likelihood that tracts burdened by NPRI will be included therein.<sup>216</sup>

#### IV. THE DILEMMA TODAY

The Texas oil field has experienced a renaissance of sorts due to the expansion of horizontal drilling.<sup>217</sup> As the industry's reliance on this new technique increases, operators will face an exponentially greater likelihood that one or more of the tracts in a horizontally planned unit will be burdened by NPRI.<sup>218</sup> From both a legal and technological standpoint, oil and gas production is a dynamic endeavor, both blessed and burdened by constant change.<sup>219</sup> As horizontal drilling and pooling increase, the implications of Texas's expansion of NPRI owners' powers pursuant to outdated rationales developed in the vertical well era will only become more evident.<sup>220</sup> Such expansion has granted the NPRI owner power over development decisions at levels once thought the sole domain of the

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215. See *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 636 (Tex. App.—Austin 2000, pet. denied) (acknowledging horizontal wells need more assigned acreage compared to vertical wells). See generally 16 TEX. ADMIN. CODE § 3.86(d) (2013) (R.R. Comm'n of Tex., Horizontal Drainhole Wells) (stipulating the additional spacing allowances for horizontal wells).

216. See Jeffery L. Hart & J. Bruce Bennett, *Selected Pooling Issues*, in STATE BAR OF TEXAS, 27TH ANNUAL ADVANCED OIL, GAS AND ENERGY RESOURCES LAW COURSE 13 (Oct. 8–9, 2009) (noting the complexity of dealing with proliferating NPRI). Sellers of real property are increasingly reserving NPRI from real property conveyances; when considered in light of increasing reliance on pooling, this sets the stage for an increase in problems for potential drilling operations. *Id.*

217. See Rafael Andrea, *Evaluating Production Potential of Mature US Oil, Gas Shale Plays*, OIL & GAS J., Dec. 2012, at 58 (crediting horizontal drilling for a “megatransformation” of the oil and gas industry); Christy M. Schweikhardt, Note, *Horizontal Perspective: Texas Oil & Gas Law in Light of Horizontal Drilling Technology*, 34 S. TEX. L. REV. 329, 329 (1993) (identifying horizontal drilling as the cause of a “mini-boom” in Texas oil and gas industry).

218. See Jeffery L. Hart & J. Bruce Bennett, *Selected Pooling Issues*, in STATE BAR OF TEXAS, 27TH ANNUAL ADVANCED OIL, GAS AND ENERGY RESOURCES LAW COURSE 13 (Oct. 8–9, 2009) (describing the proliferation of NPRI as sellers of real property retain mineral interests).

219. See 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, 216 (2002) (acknowledging the rapid advance in horizontal drilling technology caused many oil and gas legal concepts to lag behind); Christy M. Schweikhardt, Note, *Horizontal Perspective: Texas Oil & Gas Law in Light of Horizontal Drilling Technology*, 34 S. TEX. L. REV. 329, 334–35 (1993) (discussing the legal challenges posed, and the dearth of case law on point).

220. See *Montgomery v. Rittersbacher*, 424 S.W.2d 210, 215 (Tex. 1968) (granting an NPRI owner the power to ratify or repudiate a pooling provision of a lease); *Brown v. Smith*, 141 Tex. 425, 174 S.W.2d 43, 46 (1943) (mandating the consent of an NPRI owner before the interest can be pooled); *MCZ, Inc. v. Triolo*, 708 S.W.2d 49, 53–54 (Tex. App.—Houston [1st Dist.] 1986, writ ref'd n.r.e.) (extending NPRI owners ability to ratify individual leasing transactions while repudiating other leasing transactions).

executive rights owner.<sup>221</sup>

As previously mentioned, an operator has no power to pool an interest in the absence of express authority.<sup>222</sup> Thus, under the nonapportionment rule,<sup>223</sup> when lands are not properly pooled, the proceeds of production are distributed to the owner of the minerals on the tract where production is obtained, a location otherwise known as the "drillsite tract."<sup>224</sup> In a vertical well scenario, only the NPRI owner in the drillsite tract (that is, the tract upon which the actual, physical wellbore is located) can refuse consent to pooling and insist upon the full share of production from the well under the rule of nonapportionment and cross-conveyance theory of pooling.<sup>225</sup> However, the rule of nonapportionment cuts both ways.<sup>226</sup> Where an NPRI owner in a nondrillsite tract fails to authorize pooling, his or her interest will not be cross-conveyed unless he or she consents.<sup>227</sup> Because he or she has not consented to inclusion in the unit, and the production is not obtained from his or her tract, he or she will receive no royalty.<sup>228</sup>

The rise of horizontal well drilling has radically expanded the notion of

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221. See, e.g., Allen D. Cummings, *Pooling and Community Leases: Problems and Options for the Executive Owner, the Non-Executive Owner and the Lessee*, in STATE BAR OF TEXAS, 15TH ANNUAL ADVANCED OIL, GAS AND MINERAL LAW COURSE, at I-1, I-30 (1997) (highlighting an NPRI owner's refusal to ratify a lease before drilling commences could force a relocation of the well to avoid potential royalty issues).

222. *Jones v. Killingsworth*, 403 S.W.2d 325, 328 (Tex. 1965); *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 634 (Tex. App.—Austin 2000, pet. denied) (citing *Se. Pipe Line Co. v. Tichacek*, 997 S.W.2d 166, 170 (Tex. 1999)).

223. See James E. Key, *The Right to Royalty: Pooling and the Capture of Unburdened Interests*, 17 TEX. WESLEYAN L. REV. 69, 70–71 (2010) (detailing under the rule of nonapportionment, royalty from leased land that is later subdivided belongs to the owner of the tract where the well is located); Christy M. Schweikhardt, Note, *Horizontal Perspective: Texas Oil & Gas Law in Light of Horizontal Drilling Technology*, 34 S. TEX. L. REV. 329, 339 (1993) (describing the nonapportionment rule as applying to land subdivided subsequent to an executed lease and stating only the owner of the tract on which the well is located is entitled to the royalty).

224. *Japhet v. McRae*, 276 S.W. 669, 670 (Tex. Comm'n App. 1925, judgm't adopted).

225. E.g., *Guar. Nat'l Bank & Trust of Corpus Christi v. May*, 395 S.W.2d 80, 82 (Tex. Civ. App.—Waco 1965, writ ref'd n.r.e.) (affirming NPRI owners on drillsite tract were entitled to their full undivided half interest in royalties for production because they refused to ratify a pooling agreement and no cross-conveyance of interests occurred).

226. E.g., *Japhet*, 276 S.W. at 670 (declaring the basic rule of nonapportionment such that where no pooling exists, only the drillsite tract owner receives royalties).

227. Cf. *id.* (refusing payment of royalties to a royalty interest owner in a nondrillsite tract under the same lease in the absence of pooling).

228. Cf. *id.* (deciding that when multiple tracts are covered under the same lease, only the owner of the royalty interest of the tract on which the well is located is entitled to royalties in the absence of pooling).

the drillsite tract.<sup>229</sup> Now, any tract penetrated by a perforated or producing portion of the horizontally drilled lateral wellbore is a drillsite tract.<sup>230</sup> Where a horizontally drilled well penetrates multiple tracts with differing ownership, we now have the possibility of multiple drillsite tracts in a pooled unit each burdened by distinct NPRI's.<sup>231</sup> Any one, all, or some combination of the NPRI owners with an interest in production from the horizontal well may in turn refuse to ratify.<sup>232</sup> Instead, they could elect to participate in production from the well on an unpooled basis as a non-consenting royalty interest owner. Unlike the vertical well scenario, there is now confusion as to the extent of that participation of interest. With multiple drillsite tracts for a single horizontal well, including those in which the non-consenting interest owner does not own an interest, what amount of production from the entire well is he or she entitled to base his or her fractional interest upon? At least theoretically, the possibility exists that the non-consenting NPRI owner may insist on his or her full share of production from the entire well.<sup>233</sup> The most troubling scenario would include multiple drillsite tracts burdened with NPRI's in a single horizontally drilled unit, where the NPRI owners refuse to participate in the proceeds of production on a pooled basis.<sup>234</sup> It is easy to see that royalty burdens from the non-consenting NPRI's can quickly exceed those anticipated by the lessee.<sup>235</sup> As the operator, what is to be done?

Such NPRI owner elections expose the operator to massive uncertainty as to the potential royalty burdens.<sup>236</sup> At the heart of this confusion is the

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229. See *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 634 (Tex. App.—Austin 2000, pet. denied) (describing how the rise of horizontal drilling shifted the scope of a drillsite tract).

230. *Id.*; see also 16 TEX. ADMIN. CODE § 3.86(a)(2) (2013) (R.R. Comm'n of Tex., Horizontal Drainhole Wells) (defining horizontal drainhole as a portion of wellbore in the correlative interval).

231. *Cf. Luecke*, 38 S.W.3d at 638 (illustrating a situation in which a horizontal well crossed several tracts with different royalty interest owners).

232. *Cf. id.* (reciting facts of case where the royalty interest owners refused to amend their pooling agreement to allow lessee to create a unit for a horizontal well).

233. See, e.g., *id.* at 639, 647 (summarizing appellee's argument, though later rejected by the court, that the owners of the royalty interests on two tracts of land a horizontal well passed through were entitled to the full royalty on all the oil produced from the well in the absence of a valid pooling agreement).

234. See, e.g., *id.* at 639 (addressing a situation in which royalty interest owners of two tracts of a horizontal well refused to pool and demanded full royalties).

235. See, e.g., *id.* ("According to [lessees'] expert, the Lueckes' share of production would result in royalties totaling \$202,421.05 . . . . The jury assessed total damages of \$833,256 . . . .") (footnote omitted).

236. See, e.g., *id.* (suggesting the great amount of uncertainty in royalties owed to interest owners, with interest owners believing they are owed \$1,283,242 and lessees estimating royalties at \$202,421.05).

question—Who shall bear the burden of potential excess royalty? The operator is now faced with the potentially ruinous question—If we drill the wells, who gets what? Is each NPRI owner entitled to his or her fractional share of production from the entire wellbore? Is the royalty interest owner entitled to royalties on all production from that portion of the lateral penetrating only the burdened tract? How are such royalty calculations measured?

Texas jurisprudence on the issue of non-consenting or non-ratifying NPRI owners developed according to the precepts of vertical well production.<sup>237</sup> Currently, it is unclear as to the rights of non-consenting NPRI owners whose tracts are penetrated by a horizontal wellbore.<sup>238</sup> In the classic vertical well scenario, it is well-established that when the well is physically located on a tract burdened by an NPRI, absent ratification or consent to a pro rata payment, the rule of nonapportionment allows the drillsite NPRI owner to insist on a full share of all production from the well.<sup>239</sup> That is, in such instances, if the drillsite NPRI owner is vested with a one-sixteenth NPRI, that owner can insist on a full one-sixteenth of all production obtained from the well.<sup>240</sup> The one-sixteenth is not subject to dilution on a tract participation basis—that is, according to the size of his or her tract vis-à-vis the producing unit.<sup>241</sup>

#### V. THE LEGISLATIVE ATTEMPT TO RECTIFY THE PROBLEM

Unfortunately, Texas courts and lawmakers have thus far struggled to define precisely the royalty obligations owed by an operator to non-consenting NPRI owners penetrated by a horizontal wellbore crossing multiple tracts.<sup>242</sup> Currently, there exists no binding Texas precedent dictating the allocation of production from a horizontally drilled wellbore where multiple drillsite tract owners have not agreed to pooling or to the

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237. *See id.* at 632–34 (discussing the evolution of oil and gas laws with concepts originating in the vertical well scenario and rarely applied to horizontal wells).

238. *Cf. id.* at 647 (declining to apply traditional principles to horizontal wells because of their incompatibility with the new technology).

239. *See Brown v. Getty Reserve Oil, Inc.*, 626 S.W.2d 810, 815 (Tex. App.—Amarillo 1981, writ dismissed) (awarding NPRI owners on a drillsite tract their full two-thirds of an undivided share of royalties when they refused to ratify a pooling agreement with an adjoining tract).

240. *See id.* (deciding that owners of an NPRI on a drillsite tract were entitled to their full two-thirds of one-sixteenth of production royalties because of their refusal to sign a pooling agreement).

241. *See id.* (refusing to award royalties to neighboring tract based on the percentage of land under the lease because land was not pooled).

242. *See House Comm. on Energy Res., Bill Analysis, Tex. H.B. 2087, 82d Leg., R.S. (2011)* (stressing the lack of case law on the subject of the impact of horizontal drilling on NPRI owners who do not consent to pooling).

allocation of proceeds.<sup>243</sup>

During the 82nd Legislative Session, State Representative Tom Craddick sponsored House Bill 2087,<sup>244</sup> which proposed the addition of section 91.409 to Subchapter J, Chapter 91 of the Natural Resources Code.<sup>245</sup> Citing the negative impact upon horizontal drilling and lost opportunities for Texas royalty owners and operators, this proposed legislation sought to codify the spirit of the *Browning Oil Co. v. Luecke*<sup>246</sup> holding as it addressed unpooled NPRIs.<sup>247</sup> In *Luecke*, the court determined legal principles appropriate to unpooled interests in vertical wells are often inappropriate to horizontal drilling, and thus, a new manner of allocating royalty was required.<sup>248</sup> Rather than allow multiple parties to claim a full, undiluted share of production from the entire well, the court found the better course of action would be to allocate royalties to such unpooled interests on an undiluted basis, but limited to the production obtained from their tract.<sup>249</sup> This involved determining the portion of production attributable to each party's tract with reasonable probability.<sup>250</sup>

Although the bill was reported favorably by the House Committee on Energy Resources by a vote of 9–0,<sup>251</sup> the Calendar Committee failed to schedule the bill for debate and a vote on the House floor.<sup>252</sup> As a result, the bill died in the Calendar Committee with a dearth of debate on the proposed legislation.<sup>253</sup>

It is not immediately clear how the proposed legislation slipped through the cracks of the Calendar Committee after it was reported favorably out

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243. *See id.* (proclaiming the problem of a lack of case law regarding what to do about an interest owner who has not consented to pooling when drilling a horizontal well). Only a few Texas courts touched on the issue, but none specifically dealt with NPRIs. *E.g., Luecke*, 38 S.W.3d at 647 (suggesting that royalties should be determined by the amount of production attributed to each tract with reasonable probability).

244. Tex. H.B. 2087, 82d Leg., R.S. (2011).

245. *Id.*

246. *Browning Oil Co. v. Luecke*, 38 S.W.3d 625 (Tex. App.—Austin 2000, pet. denied).

247. *See* House Comm. on Energy Res., Bill Analysis, Tex. H.B. 2087, 82d Leg., R.S. (2011) (setting out the negative effects, for interest owners, operators, and even the state of Texas, of the lack of guidance regarding unpooled NPRIs in a horizontal drilling context).

248. *Luecke*, 38 S.W.3d at 647.

249. *Id.*

250. *Id.*

251. Tex. House Comm. on Energy Res. Minutes 4, 82d Leg., R.S. (Mar. 30, 2011).

252. *See* 82(R) *History for HB 2087*, TEX. LEG. ONLINE, <http://www.capitol.state.tx.us/BillLookup/History.aspx?LegSess=82R&Bill=HB2087> (last visited Apr. 9, 2013) (indicating the bill was sent to Calendars on April 14, 2011, but never left that committee).

253. *See id.* (showing the bill was sent to the Calendar committee in April of 2011, but then died in that committee).

of the House Committee by unanimous vote.<sup>254</sup> The fact is that House Bill 2087 was a necessary and important bill, as it represented the best opportunity to date to clarify the currently un-settled rights to royalty for non-consenting, non-executive owners in horizontally developed units. Such clarity is crucial to the efficient development of mineral interests in Texas, especially with the trending increase in NPRI reservations.<sup>255</sup>

In line with the *Luecke* court's call for the amount of production from a given tract to be determined with reasonable certainty,<sup>256</sup> proposed section 91.409 sought to create a rebuttable presumption that the amount of production from a given tract could be determined by finding the proportionate share of the total perforated wellbore underlying the tract in question, i.e., the portion underlying the tract burdened by the non-consenting NPRI owner.<sup>257</sup> The calculation would apply to those NPRIs who have not ratified the lease or consented to the pooling agreement.<sup>258</sup> The formula was based on the following:

[T]he ratio of the length of the horizontal drainhole across the payee's tract between the first take point and last take point to the total length of the horizontal drainhole between the first take point and the last take point. A payor who pays such payee's non-participating royalty interest based upon the allocation method set forth in [section 91.409] shall be presumed to have accurately attributed production to that interest.<sup>259</sup>

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254. *E.g.*, House Comm. on Energy Res., Bill Analysis, Tex. H.B. 2087, 82d Leg., R.S. (2011) (emphasizing the importance of House Bill 2087 because "[t]he lost opportunity for production is a detriment to the many other interest owners in the unit who want the well to be drilled and to the state in the form of lost severance tax revenue and economic activity").

255. *See id.* ("C.S.H.B. 2087 addresses this lack of guidance by creating a presumption that the amount of oil and gas produced from a tract containing a non-pooled NPRI is proportional to the length of that part of the producing segment of the drainhole underlying the tract to the total length of the producing segment of the drainhole . . .").

256. *See* *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 634 (Tex. App.—Austin 2000, pet. denied) ("[A]n operator must first designate the proration unit and the acreage assigned to it, then certify that the acreage is productive before receiving the well's production allowable.").

257. *See* Tex. H.B. 2087, 82d Leg., R.S. 1–2 (2011) ("A payee or payor under this section may rebut the presumption that the allocation method set forth in this section accurately attributes production to the payee's non-participating royalty interest through a final order of the Railroad Commission establishing another method of allocation of production to the payee's non-participating royalty interest.").

258. *See id.* at 1 ("A payee that owns a non-participating royalty interest in a tract that has been penetrated by a horizontal drainhole well as defined by the Railroad Commission, for oil or gas, or both, but who has not ratified a lease or pooling agreement covering such tract, shall be entitled to be paid its allocated share of production proceeds from such horizontal drainhole well based upon the ratio of the length of the horizontal drainhole well . . .").

259. *See id.* (describing the formula for "allocating production from horizontal wells to non-participating royalty interests").

In short, the royalty afforded to non-consenting NPRI owners would have been dependent on how much of the producing portion of the horizontal well crossed the land burdened by the NPRI.<sup>260</sup> The more the producing portion of the horizontal well is located on the NPRI burdened lease, the less dilution of interest.<sup>261</sup> A payment based on this allocation would have enjoyed a rebuttable presumption of accurate payment, according to the production attributed to the NPRI tract in question.<sup>262</sup> Additionally, as called for in *Luecke*, this formula would have provided a means of determining the proportionate share of production that is readily available to all stakeholders without the necessity of cost-prohibitive, expert witness testimony.<sup>263</sup>

One of the most important aspects of House Bill 2087 was the rebuttable presumption protections afforded to Texas producers. Efficiency in the allocation and investment of capitol is aided greatly by certainty. Though certainty of the ultimate outcome is rare, the established rules governing the behavior of all parties allow rational actors to assess risks while generally eliminating others. Oil and gas exploration companies are no different. Under the proposed legislation, an operator who disbursed royalty according to the above formula would be presumed to have accurately allocated royalty to all interest owners, and thus greatly lessened the risk of excess royalty obligations.<sup>264</sup>

Likewise, the bill was even-handed in its regard for the rights of the royalty owner. Should the NPRI owner disagree, the bill allowed for a procedure to rebut the presumption of royalty due the non-consenting interest owner at a hearing before the Texas Railroad Commission.<sup>265</sup> In order to prevail at such a hearing, after providing notice thereof to all

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260. See House Comm. on Energy Res., Bill Analysis, Tex. H.B. 2087, 82d Leg., R.S. 1 (2011) (“C.S.H.B. 2087 amends the Natural Resources Code to entitle a payee who owns a non[-] participating royalty interest in a tract that has been penetrated by a horizontal drainhole well for oil or gas, or both, and who has not ratified a lease or pooling agreement covering the tract, to be paid the payee’s allocated share of the proceeds . . .”).

261. See *id.* at 2 (“C.S.H.B. 2087 authorizes a payor or a payee under the bill’s provisions to rebut the presumption that the allocation method provided accurately attributes to the payee’s non[-] participating royalty interest by obtaining a final order of the [R]ailroad [C]ommission establishing another method of allocation of production to the payee’s interest.”).

262. See *id.* (“The bill authorizes the payor or payee to obtain such an order to be obtained only after application, notice to each payee owning an interest in the tract that is subject to the non-participating royalty interest and the payor, and an opportunity for hearing.”).

263. See *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 647 (Tex. App.—Austin 2000, pet. denied) (listing the benefits of a formulaic approach to apportioning the share of production without the need for an expert witness).

264. Tex. H.B. 2087, 82d Leg., R.S. (2011).

265. *Id.*

royalty interest owners in the tract, the non-consenting NPRI owner would have the burden of proof to establish by clear and convincing evidence that an alternate method of royalty was more accurate.<sup>266</sup> The Texas Railroad Commission would possess the final order promulgating another method of royalty allocation to the NPRI.<sup>267</sup> The bill would not apply to units created under the Mineral Interest Pooling Act or to interests owned by the state.<sup>268</sup>

The failure of this legislation is regrettable on many levels.<sup>269</sup> As the Energy Resources Committee Report suggests, there is a dearth of authority “addressing the issue of how to account to the owner of an interest in a tract that is not subject to a pooled unit when a horizontal well is producing from multiple tracts.”<sup>270</sup> As recognized by the legislative analysis, all relevant stakeholders in horizontal oil and gas production—mineral interest owners of the tracts in question, adjacent pooled interest owners, oil and gas operators, and the state of Texas—are negatively impacted in those instances where horizontal development is either delayed or declined entirely due to prevailing uncertainty as to royalty allocation and potential attendant liabilities.<sup>271</sup> Through inaction, the legislature allowed legal uncertainty to reign rather than provide leadership on an issue that has for over a decade vexed courts, property owners, and an industry vital to the economic health of the state.<sup>272</sup>

As we have seen time and time again, technology in the oil patch has outpaced the legal framework which we employ to guarantee that mineral development takes place in a responsible, efficient manner, while respecting the private property rights of all interested parties.<sup>273</sup> Our

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266. *Id.*

267. *Id.*

268. *Id.*

269. *E.g.*, House Comm. on Energy Res., Bill Analysis, Tex. H.B. 2087, 82d Leg., R.S. 1 (2011) (“The goals of the bill [are] to prevent waste, protect correlative rights of all property interest owners, and foster certainty in property interests.”).

270. *See id.* (“It is conjectured that NPRI owners whose interest has not been pooled will receive royalty on the amount of production attributed to their tracts with reasonable probability.”).

271. *See id.* (“Many problems arise from this lack of guidance, for the most part related to sorting out commingling shares of production among multiple owners and disproportionate royalty payments, all of which delay drilling of the well.”).

272. *See 82nd Legislative Session Wrap-Up*, OFFICIAL NEWSLETTER, (Tex. Land & Mineral Owners Assoc.), 2d Quarter 2011, at 1 (“Representative government actually worked! The Legislature heard you and did not move the bill through the process.”).

273. *See* 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, 216 (2002) (“[W]ith the rapid expansion of horizontal technology use, many of the legal concepts governing oil and gas law have failed to keep pace.”); Christy M. Schweikhardt, Note, *Horizontal Perspective: Texas Oil & Gas*

courts and legislature have a duty to provide a stable and reliable legal environment that both guarantees the rights of all interest owners, and promotes efficiency of private enterprises.<sup>274</sup> Where there is uncertainty as to the status of legal rights and potential liabilities, it is incumbent upon either the judicial or the legislative branch to settle undecided questions of law so that individuals and enterprises alike may know their status thereunder.<sup>275</sup> Sadly, to the detriment of all relevant stakeholders, we have not seen such an undertaking from either branch of government on the issue of unpooled NPRIs vis-à-vis horizontally developed pooled units.<sup>276</sup>

In light of the continued absence of direction from the judicial or legislative branch on this issue, it is incumbent upon one or the other to address this issue in a meaningful way at the earliest opportunity.<sup>277</sup> The rebuttable presumption proffered by House Bill 2087 represents the most even-keeled attempt to address this issue to date, and the spirit of this

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*Law in Light of Horizontal Drilling Technology*, 34 S. TEX. L. REV. 329, 334–35 (1993) (describing the complications of the increase in horizontal drilling without proper legal regulations).

274. See 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, 241 (2002) (demonstrating the *Luecke* court's conclusion regarding to horizontal drilling, such as "if an antidilution clause fails to limit its application to vertical wells, then it is implicit that the parties intended the antidilution provision to apply to either horizontal or vertical wells"); Benjamin Robertson, Comment, *Top Lease Vultures: Title Failure, Bad Faith Pooling, and the Validity of Top Leases in the Texas Shale Plays*, 44 TEX. TECH L. REV. 463, 466 (2012) (emphasizing the need for direction because "[t]he combination of rising oil and natural gas prices in the United States, along with increased political pressure to increase domestic supply as a matter of national security, resulted in increased demands on the oil industry to find new supplies of domestic energy").

275. E.g., 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, 256 (2002) ("In order to encourage this type of drilling, both state and federal courts need to continue to foster a positive judicial environment."); Robert C. Grable, *Royalty Payments and Other Current Issues from Horizontal Wells*, 2012 NO. 4 RMMLF-INST PAPER NO. 13A, 13A-2 ("While these technological advances enabling large scale production from unconventional reservoirs have been rapid and accelerating, the evolution of common and regulatory law to this technical progress has been slow, halting[, ]and uncertain.").

276. See Robert C. Grable, *Royalty Payments and Other Current Issues from Horizontal Wells*, 2012 NO. 4 RMMLF-INST PAPER NO. 13A, 13A-1 (recognizing the need for legislation and judicial activism based on the dramatic increase in "[h]orizontal drilling and multistage fracture stimulation").

277. E.g., House Comm. on Energy Res., Bill Analysis, Tex. H.B. 2087, 82d Leg., R.S. 1 (2011) (demonstrating the increasing need for NPRI legislation because "[t]he number of NPRIs has greatly increased in recent years as a result of speculative buying and selling of oil and gas interests"); Benjamin Robertson, Comment, *Top Lease Vultures: Title Failure, Bad Faith Pooling, and the Validity of Top Leases in the Texas Shale Plays*, 44 TEX. TECH L. REV. 463, 466 (2012) ("With economic incentives from higher prices and the political desire to increase domestic production calling oil companies to action, a host of new technologies developed—technologies that made possible and highly profitable the production of oil and gas that was previously economically and technologically impossible.").

legislation should be adopted when the opportunity arises in the future.<sup>278</sup> Across the state, drill-ready projects are laying fallow, being complicated and delayed, or in the worst cases being abandoned outright due to legal uncertainty that is within the control of the judicial and legislative branches.<sup>279</sup> What Texas desperately needs is a predictable legal standard to guide informed decision-making for all interested parties faced with this situation.<sup>280</sup>

House Bill 2087 sought to provide a balanced approach that would follow the intent of *Luecke*, while providing protection and certainty to the rights of all interest owners, including the non-consenting NPRI's.<sup>281</sup> The true beauty of the proffered standard is not only in its simplicity, but also in its equal regard for all interested parties.<sup>282</sup> By allocating production according to the proportionate share of the wellbore, as opposed to a proportionate share of the pooled unit, the proposed standard both recognized the realities of horizontal pooling and allowed NPRI owners to take full advantage of the decision to either consent to pooling or reap the

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278. See House Comm. on Energy Res., Bill Analysis, Tex. H.B. 2087, 82d Leg., R.S. 2 (2011) (proposing influential legislation that addresses the rights of NPRI's and grants "the Railroad Commission of Texas [the ability] to establish an alternate method for allocation only upon showing by clear and convincing evidence that the alternate method is more accurate in attributing production to the payee's interest than the method set out by the bill's provisions").

279. See Benjamin Robertson, Comment, *Top Lease Vultures: Title Failure, Bad Faith Pooling, and the Validity of Top Leases in the Texas Shale Plays*, 44 TEX. TECH L. REV. 463, 473 (2012) (encouraging the judiciary and legislature to formally act because "[m]ineral leases are only effective as long as certain conditions are met, which become all the more difficult to meet depending on the particular terms of the modern mineral leases and the existence or nonexistence of resources"). It is also the experience of this author that drill-ready projects have been abandoned or delayed due to the complications or breakdown in negotiations regarding non-consenting royalty owners.

280. See 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, 216 (2002) (highlighting the inadequacies of the prior pooling clause because it "was created prior to the horizontal boom[,] meaning the parties most likely did not contemplate the use of horizontal technology").

281. See *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 647 (Tex. App.—Austin 2000, pet. denied) (refusing "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"); Tex. H.B. 2087, 82d Leg., R.S. (2011) (providing a proactive approach to regulating NPRI's regarding to horizontal drilling).

282. See House Comm. on Energy Res., Bill Analysis, Tex. H.B. 2087, 82d Leg., R.S. 1 (2011) ("It is the committee's opinion that this bill does not expressly grant any additional rulemaking authority to a state officer, department, agency, or institution."). *But cf.* 82nd Legislative Session Wrap-Up, OFFICIAL NEWSLETTER, (Tex. Land & Mineral Owners Assoc.), 2d Quarter 2011, at 1 ("The bill subjected landowners to one standard but exempted lands owned and maintained by the General Land Office.").

rewards of non-ratification.<sup>283</sup> However, this standard did not allow the decision to be used as both a sword and shield.<sup>284</sup>

As the court in *Luecke* recognized, due to geological differences in the tight reservoirs developed by horizontal drilling, hydrocarbons produced through horizontal wellbores are not susceptible to migration in the same fashion as found in formations traditionally targeted by vertical drilling.<sup>285</sup> Whereas before, a single vertical hole effectively drained a surrounding area exhibiting high natural porosity and permeability, horizontal wellbores now allow recovery of hydrocarbons from tight formations not otherwise susceptible to such migration.<sup>286</sup> Due to decreased permeability and porosity, even in the presence of hydraulic fracture stimulation, production gained from one portion of the horizontal wellbore would not necessarily be subject to production from another portion of that same wellbore, as the hydrocarbons may be physically prevented from migrating.<sup>287</sup> In the past, pursuant to the rule of capture, a landowner could claim immunity from liability for producing his or her neighbor's hydrocarbons where the molecules produced from his or her wellbore migrated from a neighboring tract.<sup>288</sup>

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283. See House Comm. on Energy Res., Bill Analysis, Tex. H.B. 2087, 82d Leg., R.S. 1 (2011) (ratifying the current NPRI laws where “an NPRI cannot be pooled into a unit unless the owner of the NPRI ratifies the lease or unit designation”); Christy M. Schweikhardt, Note, *Horizontal Perspective: Texas Oil & Gas Law in Light of Horizontal Drilling Technology*, 34 S. TEX. L. REV. 329, 338 (1993) (emphasizing the potential problems with horizontal drilling allocations when the “surface acreage basis” method inevitably fails to determine appropriate allocation standards).

284. See House Comm. on Energy Res., Bill Analysis, Tex. H.B. 2087, 82d Leg., R.S. (2011) (proposing an equitable solution for all parties involved in horizontal drilling).

285. See *Luecke*, 38 S.W.3d at 635 (describing the promising returns from horizontal drilling because “[h]orizontal wells have been said to recover anywhere from two to five times the hydrocarbons of a vertical well”).

286. See Symposium, *Shaking Up Established Case Law and Regulation: The Impacts of Hydraulic Fracturing*, 57 THE ADVOC. (TEX.) 18, 22 (2011) (“With regard to shale formations, horizontal drilling is the only way in which production of hydrocarbons can be cost effective. Although horizontal wells are very expensive to drill and complete, the costs of drilling multiple vertical wells into a shale formation to produce the same amount of hydrocarbons as a single horizontal well would be cost prohibitive.”).

287. See Benjamin Robertson, Comment, *Top Lease Vultures: Title Failure, Bad Faith Pooling, and the Validity of Top Leases in the Texas Shale Plays*, 44 TEX. TECH L. REV. 463, 471 (2012) (“As horizontal drilling technology advanced, it allowed for many more subsurface production points. Not only could a single wellbore bend towards the resource it sought to capture, but a single drilling pad location could drill multiple wellbores, thereby reducing surface-related drilling and production costs . . .”).

288. See 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, 220 (2002) (“[W]hen the exploration of oil and gas takes place and a vertical well extracts hydrocarbons, there is a great difficulty in determining the origin of the oil and gas produced.”); Christy M. Schweikhardt, Note,

For tight formations, such wide-reaching drainage from neighboring lands may no longer be the case.<sup>289</sup> The non-consenting NPRI owner should not be allowed to take advantage of his or her right to a full, undiluted share of production from under his or her tract, and also to hydrocarbons produced from other tracts not otherwise susceptible to drainage from his or her portion of the wellbore.<sup>290</sup> To do so, in the face of scientific knowledge as to the manner of hydrocarbon migration,<sup>291</sup> would frustrate the intent of the rule of capture,<sup>292</sup> as well as the underpinnings of NPRI consent-pooling case law<sup>293</sup> that has developed to protect the NPRI owner's right to his or her own hydrocarbons.<sup>294</sup> In such instances, NPRI owners could turn their defensive shield, crafted by the courts for their protection, into an offensive sword with which to gain advantages not originally intended in the rule.

As the *Luecke* decision ages and technological innovation continues, the need for a solution becomes more pressing.<sup>295</sup> The industry's ability to

*Horizontal Perspective: Texas Oil & Gas Law in Light of Horizontal Drilling Technology*, 34 S. TEX. L. REV. 329, 340 (1993) ("The rule of capture allows the royalty owner of the surface location to claim royalty to all the oil the well will produce even though the well drains oil from the adjoining tract.").

289. See Symposium, *Shaking Up Established Case Law and Regulation: The Impacts of Hydraulic Fracturing*, 57 THE ADVOC. (TEX.) 18, 22 (2011) ("The advantage of horizontal drilling is literally geometric. A lateral provides more well bore surface area exposure to a producing formation. It is also essential for drilling in formations in which 'pockets' of oil exist interspersed with limestone at the same level[,] such as in the Austin Chalk formation.").

290. See *Coastal Oil & Gas Corp. v. Garza Energy Trust*, 268 S.W.3d 1, 17 (Tex. 2008) ("[T]he rule of capture cannot be used to shield misconduct that is illegal, malicious, reckless, or intended to harm another without commercial justification . . .").

291. See Benjamin Robertson, Comment, *Top Lease Vultures: Title Failure, Bad Faith Pooling, and the Validity of Top Leases in the Texas Shale Plays*, 44 TEX. TECH L. REV. 463, 471 (2012) (distinguishing the benefits of horizontal drilling because "reservoirs are typically wider than deep, a vertical wellbore makes contact with the hydrocarbons in the wrong plane").

292. See *Coastal Oil & Gas Corp.*, 268 S.W.3d at 43 ("In considering the effects of the rule of capture, the underlying premise is that a landowner owns the minerals, including oil and gas, underneath his property.").

293. E.g., *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 646 (Tex. App.—Austin 2000, pet. denied) ("Even though the rule of capture and other principles of oil and gas law would afford the Lue[c]kes 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.").

294. See *id.* (considering "[f]actors such as the prevention of waste, protection of the rights of landowners, and maximized recovery of minerals bear upon this area of law and necessarily affect the rights of the parties").

295. See Robert C. Grable, *Royalty Payments and Other Current Issues from Horizontal Wells*, 2012 NO. 4 RMLF-INST PAPER NO. 13A, 13A ("Advancement of industry technology to make possible drilling to eve[n] deeper depths and in inhospitable environments, and to increase the recovery factor in established oil fields have been constant themes of industry progress."); Stephen Taylor Dennis, Comment, *Browning Oil Co. v. Luecke: Has Texas Illuminated a Dark Distinction Between Vertical and*

employ hydraulic fracture stimulation techniques with increasing effectiveness has caused a marked trend towards developing tight reservoirs that exhibit ever lower permeabilities and porosities.<sup>296</sup> With each passing year, it becomes more likely that hydrocarbons drained from a particular portion of a newly drilled horizontal wellbore will not be susceptible to drainage from differing portions of this same well.<sup>297</sup> Whereas the court in *Luecke* recognized that production from a horizontal well drilled in the Austin Chalk was relatively unique to the particular portion of the wellbore and not the unit as a whole,<sup>298</sup> hydraulic fracturing has only increased the truth of this statement.<sup>299</sup> At the time of *Luecke*, horizontally drilled wells, particularly in the Austin Chalk, were “open hole” wells that relied relatively little on hydraulic fracture stimulation.<sup>300</sup> These wells produced hydrocarbons by drilling perpendicular to numerous naturally occurring fractures in the targeted formation.<sup>301</sup>

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*Horizontal Drilling?*, 34 ST. MARY'S L.J. 215, 217 (2002) (recognizing the issue in *Luecke* “was one of first impression in Texas as well as the first attempt to create a legal distinction between horizontal and vertical wells”).

296. See Robert C. Grable, *Royalty Payments and Other Current Issues from Horizontal Wells*, 2012 NO. 4 RMMLF-INST PAPER NO. 13A, 13A (“This ‘unconventional reservoir’ development has spread from its beginnings with gas wells in the Barnett Shale of North Texas, to gas wells in the Woodford, Fayetteville, Haynesville and Marcellus Shales, to tight oil plays that are now reaping extraordinary success from the Bakken Shale of North Dakota in the North, to the Eagle Ford Shale in the Gulf Coast region of Texas in the South.”); Benjamin Robertson, Comment, *Top Lease Vultures: Title Failure, Bad Faith Pooling, and the Validity of Top Leases in the Texas Shale Plays*, 44 TEX. TECH L. REV. 463, 472 (2012) (“Naturally, hydrocarbons flow through open spaces better than through nonpermeable rocks, and thus, fracking provides an invaluable method of increasing productivity in the shale plays.”).

297. See 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, 256 (2002) (“Horizontal drilling is an exciting technology that has vastly improved the efficiency of extracting hydrocarbons and has substantially reduced waste associated with traditional drilling techniques.”) (footnote omitted).

298. See *Luecke*, 38 S.W.3d at 646–47 (“A reasonably prudent operator may conclude that horizontal drilling in the Austin Chalk formation will benefit a lessor, and the operator may correctly opine that reasonable prudence dictates the drilling of a horizontal well that exceeds the authority granted under the applicable lease.”).

299. E.g., Benjamin Robertson, Comment, *Top Lease Vultures: Title Failure, Bad Faith Pooling, and the Validity of Top Leases in the Texas Shale Plays*, 44 TEX. TECH L. REV. 463, 472 (2012) (promoting the benefits of hydraulic fracturing, such as “allowing between five and fifty times more production from the well”).

300. See *Luecke*, 38 S.W.3d at 645 (“[T]he Austin Chalk formation has low porosity and low permeability. It is also highly fractured. Due to these characteristics, few vertical wells were successful in the Austin Chalk prior to the advent of horizontal drilling.”).

301. See *id.* (“The ability of a horizontal well to drain an elongated area depends upon the number of fractures encountered and the length of the drainhole.”); Stephen Taylor Dennis,

Today, hydraulic fracturing plays a much greater role, as horizontal drilling allows the industry to target increasingly dense, or tight formations.<sup>302</sup> From a legal perspective, this continues to weaken the rule of capture amongst the horizontally pooled tracts, and decreases the likelihood that hydrocarbons produced from the wellbore underlying any given tract would have migrated to another portion of the same wellbore within the unit.<sup>303</sup>

The proposed formula in House Bill 2087 recognized this reality, and sought to isolate the undiluted production of the particular tract in question to which the non-consenting NPRI owner was entitled.<sup>304</sup> While the proposed formula protected the NPRI owner's right to decline a cross-conveyance of his or her interest in the unit and insist on a full share of undiluted production from under his or her tract, it expressly limited this interest owner's ability to seek simultaneously to benefit from production obtained elsewhere.<sup>305</sup> In other words, the NPRI owner would not be allowed to enjoy the benefits of both full-undiluted production from under his or her tract on an unpooled basis, while also enjoying the benefits of production that we now know was obtained on a tract in which he or she owned no interest.<sup>306</sup> This is particularly important considering that our understanding of reservoir dynamics has matured to the point where old concepts—such as the rule of capture—may be limited when applied to tight formation development.<sup>307</sup> In light

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Comment, *Browning Oil Co. v. Luecke: Has Texas Illuminated a Dark Distinction Between Vertical and Horizontal Drilling?*, 34 ST. MARY'S L.J. 215, 250 (2002) (“[U]nlike vertical drilling where a pool exists that can be naturally drained by a neighboring tract, horizontal drilling encounters skinny fractured formations that do not necessarily drain from a contiguous neighboring tract.”).

302. See Symposium, *Shaking Up Established Case Law and Regulation: The Impacts of Hydraulic Fracturing*, 57 THE ADVOC. (TEX.) 18, 21 (2011) (“When the charges are blown, perforations are made in the sides of the lateral. These perforations are where fracing fluid will flow through and out into the formation. After the fracing process, hydrocarbons will flow into the well bore through the same perforations.”).

303. See *Luecke*, 38 S.W.3d at 646 (“Even more important is the distinction that vertical wells penetrate one tract and recover hydrocarbons from that one tract and recover hydrocarbons from that one tract whereas horizontal wells have multiple drillsites on multiple tracts.”).

304. See House Comm. on Energy Res., Bill Analysis, Tex. H.B. 2087, 82d Leg., R.S. (2011) (addressing the problems associated with NPRIs, which “are formed outside of a lease context and commonly occur when a land broker buys an oil and gas interest and retains a royalty interest of a few percent when the broker subsequently sells the interest”).

305. Tex. H.B. 2087, 82d Leg., R.S. (2011).

306. *Id.*; see House Comm. on Energy Res., Bill Analysis, Tex. H.B. 2087, 82d Leg., R.S. 1 (2011) (“[A]n NPRI owner who has not consented to the pooling of its interest in a vertical well should be paid on a tract basis . . .”).

307. See *Coastal Oil & Gas v. Garza Energy Trust*, 268 S.W.3d 1, 17 (Tex. 2008) (“Accordingly, we hold that damages for drainage by hydraulic fracturing are precluded by the rule of capture.”). It

of such increased awareness, it is incumbent upon our legal system to incorporate this knowledge into our guiding principles.<sup>308</sup> To knowingly continue the application of a concept in those circumstances where it has become obsolete, even for the sake of legal continuity, does a disservice to the legal system as a whole, and all those served by it.<sup>309</sup>

It is important to note three significant ramifications of a proportionate wellbore ratio:

A. *A Proportionate Wellbore Ratio Encourages Development of Texas's Oil and Gas Resources by Establishing a Legal Framework to Guide All Stakeholders*<sup>310</sup>

1. *Rejects Confusion of Goods Theory*<sup>311</sup>

Though such a standard would allow for further consideration by the Railroad Commission if challenged, it practically eliminates from consideration the confusion of goods theory that has been roundly criticized in its application to horizontal production, and ultimately rejected by the *Luecke* court.<sup>312</sup>

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is important to note the rebuttable presumption of the proposed House Bill 2087 allows for NPRI owners to contest the method of royalty allocation. Tex. H.B. 2087, 82d Leg., R.S. (2011). Where it is proven that geology or other factors demand an alternate method of royalty allocation, the Railroad Commission is empowered to issue an order to that effect. *See* *Brown v. Humble Oil & Ref. Co.*, 83 S.W.2d 935, 939 (Tex. 1935) (reinforcing the Texas Railroad Commission's power to enforce rules, regulations, and orders).

308. *See* House Comm. on Energy Res., Bill Analysis, Tex. H.B. 2087, 82d Leg., R.S. (2011) (urging the need for House Bill 2087 because of the lack of guidance regarding horizontal wells producing on multiple tracts).

309. *Cf.* *Graham v. Florida*, 130 S. Ct. 2011, 2021 (2010) (recognizing "courts must look beyond historical conceptions to the 'evolving standards of decency that mark the progress of a maturing society.'" (citing *Estelle v. Gamble*, 429 U.S. 97, 102 (1976))).

310. *See* *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 646 (Tex. App.—Austin 2000, pet. denied) (describing how to deal with horizontal wells that were not properly pooled); *see also* Tex. H.B. 2087, 82d Leg., R.S. (2011) (proposing horizontal drainhole without a lease or proper pooling agreement will pay the payee based on a "share of production proceeds from such horizontal drainhole well based upon the ratio of the length of the horizontal drainhole across the payee's tract between the first take point and last take point").

311. *See* *Humble Oil & Ref. Co. v. West*, 508 S.W.2d 812, 818 (Tex. 1974) ("[I]he confusion of goods theory attaches only when the commingled goods of different parties are so confused that the property of each cannot be distinguished").

312. *See* *Luecke*, 38 S.W.3d at 649 (rejecting the confusion of good theory because the surface tract royalty owners were aware the pooling was unauthorized).

## 2. Benefits to Operators

A rebuttable presumption of reasonable action as proposed by House Bill 2087 would enable operators active in Texas to develop prospects burdened by non-consenting NPRI's, free from concern that crushing excess royalty burdens would follow.<sup>313</sup> Currently, operators face the prospect that competing claims to royalties from horizontal wells may create economic burdens that prevent such projects from ever becoming profitable.<sup>314</sup> Rather than gamble, such projects are delayed or abandoned.<sup>315</sup> In such instances, operators must absorb enormous sunk costs in terms of lease acquisition and land related expenses that will never be recouped.<sup>316</sup> By providing a reasonable, equitable, and certain legal standard for operators, this proposed legislation encourages exploration and production activity that would have been otherwise delayed or avoided all together.<sup>317</sup>

## 3. Benefits to Mineral Owners

Under current conditions, entire proposed drilling units are subject to delay or abandonment due to the uncertainties posed by the royalty allocation question regarding non-consenting NPRI's.<sup>318</sup> Unfortunately,

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313. See House Comm. on Energy Res., Bill Analysis, Tex. H.B. 2087, 82d Leg., R.S. 1 (2011) ("The goals of the bill [are] to prevent waste, protect correlative rights of all property interests owners, and foster certainty in property interests.").

314. *Id.* As explained below, the lack of case law in this area creates problems:

Under case law, an NPRI owner who has not consented to the pooling of its interest in a vertical well should be paid on a tract basis as if no unit designation is in effect, but there is little case law addressing the issue of how to account to the owner of an interest in a tract that is not subject to a pooled unit when a horizontal well is producing from multiple tracts. Many problems arise from this lack of guidance, for the most part related to sorting out commingling shares of production among multiple owners and disproportionate royalty payments, all of which delay drilling of the well. The lost opportunity for production is a detriment to the many other interest owners in the unit who want the well to be drilled and to the state in the form of lost severance tax revenue and economic activity.

*Id.*

315. See *id.* (recognizing the current lack of guidance regarding multiple tract horizontal wells causes delays).

316. Cf. *Coastal Oil & Gas v. Garza Energy Trust*, 268 S.W.3d 1, 34 (Tex. 2008) (Willett, J., concurring) (recognizing increased exploration costs will negatively impact state generated oil and gas revenue).

317. See House Comm. on Energy Res., Bill Analysis, Tex. H.B. 2087, 82d Leg., R.S. (2011) (stating the goal of HB 2087, among other things, is to "protect correlative rights of *all* property interest owners") (emphasis added).

318. Cf. *Coastal Oil & Gas*, 268 S.W.3d at 41 (Willett, J., concurring) (noting the damages of premature abandonment of producing wells).

operators and NPRI owners are not the only economic actors who suffer when such projects are stalled or abandoned.<sup>319</sup> Generally, NPRI owners make up only a small percentage of the royalty interest owners in such pooled units, which are composed primarily of executive mineral owners.<sup>320</sup> When drilling projects are delayed or abandoned due to uncertainty as to royalty allocations amongst unpooled NPRI owners, all mineral interest owners in the proposed unit lose the opportunity to have their minerals developed.<sup>321</sup> This is particularly troubling when you consider that a relatively small, minority, non-executive interest is able to frustrate the intent of those executive interest owners in developing their mineral estates, and not solely for the tract burdened by the NPRI.<sup>322</sup> Due to the nature of such proposed horizontal units, a large quantity of acreage, the majority of which the NPRI owner likely has no interest in, will have been grouped together to form a drilling unit.<sup>323</sup> The uncertainty caused by the lack of consent on one or more tracts now stymies the intent of all executive interest owners in the proposed unit, including those that are not burdened by an NPRI but have the unfortunate luck to have been located adjacent or nearby.<sup>324</sup>

#### 4. State of Texas

It is not just royalty interest owners that suffer—the state of Texas has skin in the game as well.<sup>325</sup> Where such projects are delayed or

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319. *See, e.g.*, *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 643 (Tex. App.—Austin 2000, pet. denied) (recognizing both the lessees and lessors experienced damages from lack of proper pooling of a horizontal well).

320. *Cf.* Lee Jones, Jr., *Non-Participating Royalty*, 26 TEX. L. REV. 569, 569–70 (1948) (recognizing it is the executive interest owner who has the ultimate right to the land and NPRI rights are inherently subservient to the executive interest owner's actions).

321. *See Coastal Oil & Gas*, 268 S.W.3d at 41 (Willett, J., concurring) (noting premature abandonment of wells wastes resources); *see also* TEX. NAT. RES. § 85.045 (West 2011) (stating waste in oil and gas production is unlawful).

322. Because an NPRI cannot be pooled without consent, if there is not an active proportionate wellbore ratio, an NPRI can frustrate the entire horizontal well, no matter how small the NPRI's tract is. *See* House Comm. on Energy Res., Bill Analysis, Tex. H.B. 2087, 82d Leg., R.S. (2011) (recognizing the problem of horizontal wells covering multiple unpooled tracts).

323. *See, e.g., Luecke*, 38 S.W.3d at 644 (involving a case where lessors unsuccessfully attempted to attain royalties from lessees on a nonpooled horizontal well).

324. *But see* House Comm. on Energy Res., Bill Analysis, Tex. H.B. 2087, 82d Leg., R.S. (2011) (stating HB 2087 attempted to foster certainty of property interests between adjacent, unpooled tracts by implementing a proportionate wellbore ratio).

325. *See Coastal Oil & Gas*, 268 S.W.3d at 39 (Willett, J., concurring) (“Hydraulic fracturing occurs daily throughout Texas, encouraged by state tax law aimed at boosting production from tight, hydrocarbon-bearing formations, and is a technique championed by the agency vested with broad powers to regulate it.”).

abandoned, Texas is unable to realize significant tax revenue that would have otherwise accrued on production.<sup>326</sup> Given Texas's dependence upon oil and gas revenues, particularly in times of economic hardship, the state has a clear interest in promoting the equitable development of these otherwise troubled oil and gas projects.<sup>327</sup>

B. *A Proportionate Wellbore Ratio Enshrines Judicially-Developed Protections for the NPRI Owner*

Most importantly for the NPRI owner, this standard maintains his or her ability to realize the full undiluted share of production from his or her tract, should it refuse to consent to the pooling of his or her interest.<sup>328</sup> Texas law additionally makes it clear that an NPRI owner may consent to pooling either before or after a well has been drilled, so long as the election is made within a reasonable amount of time.<sup>329</sup> In the event of a horizontally pooled unit, the NPRI owner will likely have at best only a general estimation of that portion of a planned horizontal wellbore that will penetrate his or her tract.<sup>330</sup> Greater still, any such unit may contain multiple wellbores, most of which do not penetrate the NPRI burdened tract.<sup>331</sup> The NPRI owner in such a scenario would be able to more accurately weigh the costs and benefits of ratification, by comparing the benefits of a reduced percentage of a greater number of wells with a higher percentage of a portion of one well.<sup>332</sup> The rebuttable presumption

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326. See TEX. TAX CODE ANN. § 202.051 (West 2008) (imposing a tax on all production of oil in Texas).

327. See generally *Coastal Oil & Gas*, 268 S.W.3d at 26–29 (Willett, J., concurring) (outlining the significant breadth and dependence of Texas' oil and gas production).

328. See Tex. H.B. 2087, 82d Leg., R.S. (2011) (proposing a payee whose NPRI is penetrated by a horizontal well but does not have an agreed pooling lease is still entitled to his or her legally due royalties).

329. See *Tittizer v. Union Gas Corp.*, 171 S.W.3d 857, 860 (Tex. 2005) (“A lessee has no power to pool without the lessor’s express authorization, usually contained in the lease’s pooling clause.”). See generally TEX. NAT. RES. §§ 102.001 *et seq.* (West 2011) (stating the general provisions of Texas pooling).

330. *But see* House Comm. on Energy Res., Bill Analysis, Tex. H.B. 2087, 82d Leg., R.S. (2011) (“C.S.H.B. 2087 authorizes a payor or payee under the bill’s provisions to rebut the presumption that the allocation method provided accurately attributes to the payee’s non-[participating] royalty interest by obtaining a final order of the railroad commission establishing another method of allocation of production to the payee’s interest.”).

331. See, e.g., *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 649 (Tex. App.—Austin 2000, pet. denied) (refusing to allow royalties for non-pooled adjacent wellbores, despite sharing a horizontal well).

332. House Bill 2087’s attempted goal of certainty and predictability would allow NPRI owners to know their most attractive option, instead of the current state of ambiguity. See House Comm. on Energy Res., Bill Analysis, Tex. H.B. 2087, 82d Leg., R.S. (2011) (“The goals of the bill to prevent

offered in House Bill 2087 fully respected the NPRI owner's ability to await the drilling results and elect or decline to pool his or her interest.<sup>333</sup>

House Bill 2087 provided an additional significant protection to the NPRI owner through its employment of the rebuttable presumption.<sup>334</sup> Though one of the key strengths of the failed legislation was its simplicity and efficiency, the bill implicitly recognized that one single standard would not fit all situations.<sup>335</sup> This is particularly important in light of significant geological differences that can exist not only on a macrolevel amongst the geographic regions commonly known as 'plays,' but also on a microlevel from within a producing play itself.<sup>336</sup> Not all rocks are created equal, and the presence of faulting and karsting can cause an area within miles of prolific production to prove barren.<sup>337</sup> Rather than bind the NPRI owner to a rigid standard, the proposed standard implicitly recognized the unique geological nature of hydrocarbon bearing formations and created a procedure for the NPRI owner to demonstrate that an alternate method of allocating production was warranted.<sup>338</sup>

C. *While Protecting the Rights of the NPRI Owner, the Proposed Legislation Also Implicitly Recognized the Non-Executive Nature of the NPRI*<sup>339</sup>

This seemingly minor implication is critical in light of the recent trend in Texas oil and gas jurisprudence to advance the power of the NPRI.<sup>340</sup>

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waste, protect correlative rights of all property interest owners, and foster certainty in property interests.”).

333. Tex. H.B. 2087, 82d Leg., R.S. (2011).

334. *Id.*

335. By including the rebuttable presumption, House Bill 2087 allowed some leeway in interpretation when dealing with horizontal wells over unpooled tracts. *See id.* (allowing payors or payees to rebut the presumption of the proposed proportionate wellbore ratio).

336. *See* Craig C. Freudenrich, *How Oil Drilling Works*, ENERGY CAPITAL GRP., <http://www.encapgroup.com/drilling/> (last visited Apr. 9, 2013) (showing how folding, faulting, and pinching out can trap oil from being extracted).

337. *See id.* (pointing out how faulting occurs when layers of rock crack and force layers of rock to simultaneously go upward and downward, thus trapping the oil and gas).

338. *See* Tex. H.B. 2087, 82d Leg., R.S. 1 (2011) (“A payee or payor under this section may rebut the presumption that the allocation method set forth in this section accurately attributes production to the payee’s non-participating royalty interest through a final order of the Railroad Commission establishing another method of allocation of production to the payee’s non-participating royalty interest.”).

339. *See id.* (noting the proposed legislation would apply to those who own an NPRI in a tract and have “not ratified a lease or pooling agreement covering such tract”); *see also In re Bass*, 113 S.W.3d 735, 745 (Tex. 2003) (“By definition, all non-participating royalty interests are non-executive interests.” (citing *Plainsmen Trading Co. v. Crews*, 898 S.W.2d 786, 789–90 (Tex. 1995))).

340. *See Lesley v. Veterans Land Bd.*, 352 S.W.3d 479, 490 (Tex. 2011) (“The duty of the executive to the non-executive is ‘fiduciary[.]’ we explained, citing cases that have long characterized

Under House Bill 2087, NPRI owners would be expressly denied the ability to use the current state of legal confusion to effectively achieve executive status by demanding executive benefits, such as bonus payment or higher lease royalty amounts for ratification.<sup>341</sup> Though the legislation would fully protect their rights as to their tracts, such owners would no longer be able to prevent or delay entire development prospects in order to negotiate benefits that are the hallmark of an executive interest.<sup>342</sup>

Additionally, the proposed standard recognized the NPRI's non-executive nature by denying the ability to refuse to consent to pooling in a simultaneously offensive and defensive manner.<sup>343</sup> While protecting the NPRI owner's right to decline a cross-conveyance of his or her interest in the unit and insist on a full share of undiluted production from under his or her tract, this formula expressly limited this interest owner's ability to simultaneously seek to benefit from production obtained elsewhere.<sup>344</sup>

A proportionate share of the wellbore formula also respected the

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this relationship as one 'of trust[,] with a duty of 'utmost fair dealing.'" (citing *Manges v. Guerra*, 673 S.W.2d 180, 183 (Tex. 1984)); *Friddle v. Fisher*, 378 S.W.3d 475, 481 (Tex. App.—Texarkana 2012, pet. denied) ("[A] person holding the executive rights must acquire for the holder of the nonexecutive right every benefit he exacts for himself—that is, he must execute the same type of oil and gas lease on the same terms as he would have done in the absence of an outstanding, non[-] participating interest.") (citation omitted).

341. See Tex. H.B. 2087, 82d Leg., R.S. (2011) (establishing how non-participating royalty interest payments would be calculated for tracts involving horizontal drilling); see also *French v. Chevron U.S.A. Inc.*, 896 S.W.2d 795, 797 (Tex. 1995) ("A mineral estate consists of five interests: (1) the right to develop, (2) the right to lease, (3) the right to receive bonus payments, (4) the right to receive delay rentals, and (5) the right to receive royalty payments.") (alteration not in original); *Hamilton v. Morris Res., Ltd.*, 225 S.W.3d 336, 344 (Tex. App.—San Antonio 2007, pet. denied) ("[An NPRI] is 'an interest in the gross production of oil, gas, and other minerals carved out of the mineral fee estate as a free royalty, which does not carry with it the right to participate in the execution of, the bonus payable for, or the delay rentals to accrue under, oil, gas, and mineral leases executed by the owner of the mineral fee estate.'" (quoting *Plainsman Trading Co.*, 898 S.W.2d at 789–90)).

342. See Tex. H.B. 2087, 82d Leg., R.S. (2011) (setting a default method of calculating NPRI payments from horizontal wells that ensures the NPRI holder receives a proportionate share of production proceeds); see also *Andretta v. West*, 415 S.W.2d 638, 641 (Tex. 1967) ("The holder of the executive right has the power to make and amend leases affecting the enjoyment of a non-participating royalty interest owned by another.").

343. See generally Tex. H.B. 2087, 82d Leg., R.S. (2011) (establishing a method of calculating payments for NPRI owners who fail to ratify a pooling agreement).

344. See *id.* (promulgating a wellbore ratio formula to pay NPRI holders—who decline to ratify a pooling agreement—a fair share of the production proceeds); see also *Montgomery v. Rittersbacher*, 424 S.W.2d 210, 213 (Tex. 1968) ("The mere reservation of a non-participating royalty interest under a tract does not show that the royalty owner intended to give to the holder of the executive rights the power to diminish the royalty owner's interest under the tract. Consequently, pooling on the part of the holder of the executive rights cannot be binding upon the non-participating royalty owner in the absence of his consent.").

difference in the share of production on a pooled and unpooled basis.<sup>345</sup> As we have seen, without consent, an NPRI owner cannot be forced to participate in unit production on a pooled unit basis.<sup>346</sup> On a pooled basis, the acreage of the tract in question is divided by the total acreage of the unit, which yields that tract's participation factor, or share of the total production from the unit.<sup>347</sup> While such a formula results in a lower fractional share of production, the consent to pooled, unit-wide participation includes production from wells that are not physically located on the tract in question.<sup>348</sup> This is particularly important when one considers that the overwhelming majority of horizontal units contain multiple wellbores.<sup>349</sup>

Under a portion of the producing wellbore basis, only those tracts overlying the producing portion of a horizontal wellbore will be considered for division of the proceeds of production.<sup>350</sup> This would yield a significantly higher fractional share of royalty for non-consenting

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345. See generally *Ohr v. Union Gas Corp.*, No. 13-05-00621-CV, 2012 WL 3757386, at \*4 (Tex. App.—Corpus Christi Aug. 31, 2012, pet. filed) (explaining the effect pooling has on production, operations, and royalty payments).

346. See *Montgomery*, 424 S.W.2d at 213 (reaffirming that non-participating royalty owners are not bound to pooling arrangements without their consent); *De Benavides v. Warren*, 674 S.W.2d 353, 360 (Tex. App.—San Antonio 1984, writ ref'd n.r.e.) (recognizing those with executive rights have “no authority to pool or unitize lands subject to [the non-participating royalty owners’] royalty interests” as NPRI owners must have the option to ratify or decline participation in such pooling).

347. See *Samson Lone Star, Ltd. P’ship v. Hooks, III*, No. 01-09-00328-CV, 2012 WL 1951113, at \*13 (Tex. App.—Houston [1st Dist.] May 31, 2012, pet. filed) (“With respect to royalty interest owners, ‘pooling results in a cross-conveyance of interests in land by agreement among the participating parties, each of whom obtains an undivided joint ownership in the royalty earned from the land in the block created by the agreement’ and each of whom receives royalty on the basis of the percentage of that party’s acreage to the whole block.” (citing *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 633 (Tex. App.—Austin 2000, pet. denied))) (some internal quotation marks omitted).

348. See *Mengden v. Peninsula Prod. Co.*, 544 S.W.2d 643, 648 (Tex. 1976) (“When a unit is properly pooled, the owners of the minerals or reversionary interests in a separate tract within the unit surrender their right to receive their interest in all production from wells located on their own tract, and in turn they receive the right to share proportionately from wells on the other included tract.” (citing *Southland Royalty Co. v. Humble Oil & Refining Co.*, 151 Tex. 324, 249 S.W.2d 914, 916 (1952))).

349. See *Luecke*, 38 S.W.3d at 635 (“[A]n operator derives economic benefit by increasing the length of the lateral wellbore to improve the chances of penetrating additional producing fractures.”); Bruce M. Kramer, *Keeping Leases Alive in the Era of Horizontal Drilling and Hydraulic Fracturing: Are the Old Workhorses (Shut-in, Continuous Operations, and Pooling Provisions) Up to the Task?*, 49 WASHBURN L.J. 283, 291 (2010) (noting horizontal well units may “contain multiple drillsites on tracts owned by multiple owners”).

350. See Tex. H.B. 2087, 82d Leg., R.S. (2011) (allocating production shares based on the proportion of well length on the NPRI owner’s tract as compared to the length of the entire horizontal well).

NPRI owners, but it would be limited in scope to that portion of the wellbore lying on their tracts—to the exclusion of all other wells.<sup>351</sup>

#### VI. WHERE DO WE GO FROM HERE?

Absent legislative or judicial solutions, the heart of the controversy—regarding who bears the potential burden of excess royalty—stands; that is, if everyone declines consent and insists upon a full fractional share of production, which then exceeds the shares provided for in the lease or the economic amount, who pays how much to whom?<sup>352</sup> Currently, the possibility exists that in the event an operator drills and produces hydrocarbons from a horizontal wellbore that penetrates several tracts, each of which are burdened by disparate, non-consenting NPRIs, each NPRI owner could insist on the full share of production undiluted on a pro rata basis.<sup>353</sup> Furthermore, additional claims based on the underpayment of royalty could be asserted by participating royalty interest owners whose royalty percentages are impacted by the NPRI claims.<sup>354</sup> In any such scenario, the operator's net revenue will potentially be subject to severe, negative impacts.<sup>355</sup> An operator in such a scenario must face the very real possibility that exposure to various undiluted NPRIs, and thus to a drastically reduced net revenue interest, could cause a well or unit to become uneconomical.<sup>356</sup>

#### VII. ADDITIONAL POTENTIAL MEASURES OF DAMAGES

In the absence of precedent, operators faced with non-consenting NPRI owners in unpooled tracts currently have no alternative other than to make

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351. *See id.* (indicating NPRI owners subject to the proposed legislation would only be entitled to production proceeds stemming from the proportionate share of wells on their tracts).

352. *See* George A. Snell, III, *Pooling—From A to Horizontal*, E. TEX. ASS'N OF PETROL. LANDMEN, 16 (Spring 2011) (on file with the *St. Mary's Law Journal*) (mentioning the problems operators face in drilling multiple tracts with non-consenting NPRI holders).

353. Such claims would be made under the confusion of goods theory. *See* Humble Oil & Ref. Co. v. West, 508 S.W.2d 812, 818 (Tex. 1974) (prescribing the general rule regarding confusion of goods theory).

354. Potential claims could include participation in the breach of duty to NPRI owners, wherein executive rights holders would attempt to shift the liability, or at least a portion thereof, to the operator. *See* De Benavides v. Warren, 674 S.W.2d 353, 355, 360 (Tex. App.—San Antonio 1984, writ ref'd n.r.e.) (involving claims filed by executive rights holders against NPRI holders and an operator, and a counterclaim filed by the NPRI holders, relating to the breach of duty to NPRI holders).

355. *See* Browning Oil Co. v. Luecke, 38 S.W.3d 625, 635 (Tex. App.—Austin 2000, pet. denied) (acknowledging the necessary balance between increased production of horizontal wells, with increased costs and potential increased risk of claims) (citations omitted).

356. *See id.* (noting the economic interests driving operators).

the best guess possible as to what constitutes a reasonable determination of the production from underneath a given tract.<sup>357</sup> In choosing this uncertain path, the following two methods of allocating production have been suggested: confusion of goods, and royalty allocated on a productive acreage basis along the horizontal drainhole.<sup>358</sup>

#### A. *Confusion of Goods*

The confusion of goods theory provides that where goods of a similar nature and value and owned by different parties are commingled so that a proper division among the owners as to their preexisting rights cannot be made (i.e., where it has become impossible to determine which particular item belongs to whom), the burden falls to the party commingling the goods to determine the shares of each of the owners.<sup>359</sup> If the commingling party is unable to make a proper division, the commingling party must take the loss and account to each of the owners as if his or her share is of the whole.<sup>360</sup>

Applying the theory to an oil and gas scenario, once it is determined that a tract burdened by an NPRI is penetrated by a horizontal wellbore in a pooled unit where the NPRI did not consent to the reduction of his or her interest or comingling of his or her production, the burden of proof shifts to the lessee to determine by a preponderance of the evidence the genesis of the production.<sup>361</sup>

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357. *See id.* at 641 (“The reasonably prudent operator standard is used in the context of a lessee’s performance of implied covenants.” (citing *Se. Pipe Line Co. v. Tichacek*, 997 S.W.2d 166, 170 (Tex. 1999))).

358. *See* George A. Snell, III, *Pooling—From A to Horizontal*, E. TEX. ASS’N OF PETROL. LANDMEN, 16 (Spring 2011) (on file with the *St. Mary’s Law Journal*) (summarizing various methods of calculating production). Other methods certainly exist, though each present inherently troubling characteristics. For example, Texas law forbids pooling on a unit basis in the absence of consent. *See* *Union Pac. Res. Co. v. Hutchison*, 990 S.W.2d 368, 370 (Tex. App.—Austin 1999, pet. denied) (citing *Montgomery v. Rittersbacher*, 424 S.W.2d 210, 213 (Tex. 1968)) (asserting that obtaining a royalty owner’s consent is required to pool tracts of land for oil and gas production).

359. *See Humble Oil & Ref. Co.*, 508 S.W.2d at 818 (describing the confusion of goods theory).

360. *See id.* (“[I]f goods are so confused as to render the mixture incapable of proper division according to the pre-existing rights of the parties, the loss must fall on the one who occasioned the mixture.”).

361. *See id.* (describing the burden involved in allocation of oil and gas production in a confusion of goods scenario); George A. Snell, III, *Pooling—From A to Horizontal*, E. TEX. ASS’N OF PETROL. LANDMEN, 16 (Spring 2011) (on file with the *St. Mary’s Law Journal*) (“[T]he operator would have to show by a preponderance of the evidence and with reasonable certainty the amount of oil and gas produced from each of the tract[s] penetrated by the horizontal wellbore.”).

[I]f the operator cannot determine with reasonable certainty the amount of production coming from each of the tracts penetrated by a horizontal wellbore, then the operator may be required to account to each of the owners of each tract penetrated as if all of the production is allocable to each tract penetrated by the wellbore.<sup>362</sup>

The confusion of goods theory presents the operator with, at best, the costly burden of determining the production attributed to a particular tract.<sup>363</sup> At worst, this theory of liability imposes the crushing burden of disbursing excess royalty far exceeding the amount rightfully entitled to each tract.<sup>364</sup> Potentially “the operator could be required to account to each of the separate tract owners as if 100% of the production came from each tract, unless the operator can show ‘with reasonable certainty’ how much production is obtained from each tract.”<sup>365</sup> Commentators have questioned whether such a determination is even “capable of being established with reasonable certainty” at all.<sup>366</sup> Unfortunately, for Texas operators, no binding case law expressly rejects this measure of damages.<sup>367</sup>

#### B. *Royalty Allocated on a Productive Acreage Basis Along the Horizontal Drainhole*

A second model of damages involves paying royalty on a productive acreage basis along the horizontal drainhole.<sup>368</sup> This is the model of damages advanced by the operator in *Luecke*.<sup>369</sup> In *Luecke*, the operator's expert “testified as to how much production could be allocated to the

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362. George A. Snell, III, *Pooling—From A to Horizontal*, E. TEX. ASS'N OF PETROL. LANDMEN, 16 (Spring 2011) (on file with the *St. Mary's Law Journal*) (emphasis omitted).

363. *See id.* (explaining the operator's burden).

364. *See id.* (addressing the consequences of failing to prove a proper division among the owners).

365. *Id.*

366. *See id.* (“An important question is whether the computation of the production allocable to each tract is capable of being established with reasonable certainty.”).

367. *See generally* *Humble Oil & Ref. Co. v. West*, 508 S.W.2d 812, 818 (Tex. 1974) (accepting the confusion of goods doctrine as an acceptable theory of recovery).

368. *See* George A. Snell, III, *Pooling—From A to Horizontal*, E. TEX. ASS'N OF PETROL. LANDMEN, 16 (Spring 2011) (on file with the *St. Mary's Law Journal*) (addressing the “pay [on] royalty on a productive acreage basis along the horizontal drainhole” method of calculating damages).

369. *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 639 (Tex. App.—Austin 2000, pet. denied). Though not specifically addressed by the *Luecke* court, at the trial level, the jury apparently rejected the theory of royalty allocation based on productive acreage. *See id.* (“The court's charge did not expressly adopt either of the proposed theories[,] but generally instructed the jury to assess damages and to consider the royalties that ‘Plaintiffs would have received under the terms of the Leases if Defendants had performed under the Leases[.]’”).

Lueckes' land based on the fractures underlying their land."<sup>370</sup> In practice, this model of damages would likely prove to be an inefficient means of allocating production because it requires expert testimony that would be cost prohibitive in the absence of litigation.<sup>371</sup> Moreover, with the advent and constant advancement of highly complex hydraulic fracture well stimulation, proof at trial, ultimately, would be the battle of educated guesses by hired experts.<sup>372</sup>

#### VIII. EPILOGUE FROM AN OIL AND GAS LAW PRACTITIONER

In line with the general reasoning in *Luecke*, NPRI owners should be allowed to extract all available benefits that flow from their vested property rights.<sup>373</sup> This includes the opportunity to refuse consent to pooling where the interest is included in a pooled unit, including one developed with horizontal wellbores.<sup>374</sup> Insistence should be made for a full, undiluted share of production.<sup>375</sup> Private property rights and

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370. *Id.*

371. See George A. Snell, III, *Pooling—From A to Horizontal*, E. TEX. ASS'N OF PETROL. LANDMEN, 16 (Spring 2011) (on file with the *St. Mary's Law Journal*) ("Obtaining [expert testimony] in order to distribute royalty from a horizontal well that is not involved in litigation would probably be prohibitive.").

372. In *Luecke*, the lessees presented expert testimony about how to best allocate production of the horizontal well to the Lueckes' tracts in response to the Lueckes' own allocation evidence. *Luecke*, 38 S.W.3d at 639. Ultimately, the issue went to the jury who came up with a third way of allocating production. *Id.* While expert opinions are the best means of determining how much production pertains to a specific tract, they do not generally provide an exact measurement. See George A. Snell, III, *Non-Consenting Mineral Interests*, DALLAS ASS'N OF PROF'L LANDMEN, 33 (Sept. 10, 2007) (on file with the *St. Mary's Law Journal*) ("Obtaining evidence as to productive acreage requires expert testimony.").

373. See *Luecke*, 38 S.W.3d at 647 ("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."); George A. Snell, III, *Non-Consenting Mineral Interests*, DALLAS ASS'N OF PROF'L LANDMEN, 31 (Sept. 10, 2007) (on file with the *St. Mary's Law Journal*) (noting lessors should only be able to recover royalties as they are specified in a lease).

374. See *Luecke*, 38 S.W.3d at 640 ("Absent express authority, a lessee has no power to pool the lessor's interests with the interests of others.") (citation omitted); see also *Se. Pipe Line Co. v. Tichacek*, 997 S.W.2d 166, 170 (Tex. 1999) (maintaining that a lessee may not pool without the lessor's consent); *Jones v. Killingsworth*, 403 S.W.2d 325, 327 (Tex. 1965) ("The lessors' land may be pooled only to the extent stipulated in the lease.").

375. See Jeffery L. Hart & J. Bruce Bennett, *Selected Pooling Issues*, in STATE BAR OF TEXAS, 27TH ANNUAL ADVANCED OIL, GAS, AND ENERGY RESOURCES COURSE 14 (Oct. 8–9, 2009) ("If the non-consenting NPRI owners are under the drillsite lease, the designated unit would not be binding on them, and they would have to be paid royalty on the full production from the well undiluted by the pooling."); George A. Snell, III, *Non-Consenting Mineral Interests*, DALLAS ASS'N OF PROF'L LANDMEN, 34 (Sept. 10, 2007) (on file with the *St. Mary's Law Journal*) (recognizing unless an operator can prove the amount of production from a specific tract, the NPRI holder is entitled to their undiluted share of the proceeds).

economic expectations of NPRI owners must be protected to the fullest extent possible.<sup>376</sup> Such individuals should be allowed to take full advantage of the opportunities presented to them by law, but nothing more.<sup>377</sup>

Texas operators, increasingly dependent upon horizontal well drilling and thus the pooling of mineral interests, must have a sensible, reasonable, and consistent method of allocating the proceeds of production when faced with non-consenting NPRI owners.<sup>378</sup> The NPRI owner must not be allowed to both claim the benefits of a refusal to consent to pooling for a horizontal well, and in the same transaction demand benefits of production from lands in which he or she maintains no ownership interest—particularly where it can be demonstrated that such extraneous production was not susceptible to production from the portion of the wellbore lying underneath his or her tract.<sup>379</sup> Confusion in Texas law

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376. See H. Philip 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, 204 (2011–2012) (“The owners under each tract traversed by a horizontal drainhole are entitled to the minerals produced from their tract.”); Jeffery L. Hart & J. Bruce Bennett, *Selected Pooling Issues*, in STATE BAR OF TEXAS, 27TH ANNUAL ADVANCED OIL, GAS, AND ENERGY RESOURCES COURSE 4 (Oct. 8–9, 2009) (explaining an NPRI is a type of property interest that entitles its holder to expense-free royalties on oil and gas produced). When royalty owners reject an offer to pool their NPRI interests, they remain the owners of the royalty production and are entitled to any payments resulting therefrom. *Id.* at 15.

377. See *Luecke*, 38 S.W.3d at 647 (“The Lueckes are entitled to the royalties for which they contracted, no more and no less.”); George A. Snell, III, *Non-Consenting Mineral Interests*, DALLAS ASS’N OF PROF’L LANDMEN, 31 (Sept. 10, 2007) (on file with the *St. Mary’s Law Journal*) (emphasizing NPRI holders are only entitled to their contracted-to royalties). It is important to note the *Luecke* court emphasized the issue was not whether the Lueckes were entitled to royalties, but was rather the amount of royalty they were owed. *Luecke*, 38 S.W.3d at 647–48.

378. See 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, 234–35 (2002) (documenting the history of horizontal drilling and the reasons for its increasing popularity); H. Philip 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, 178 (2011–2012) (“The past decade has seen an unprecedented boom in horizontal drilling and development in Texas.”). Horizontal wells made up more than 40% of all wells completed in 2011 in Texas. *Id.* at 181.

379. See generally Bruce M. Kramer, *Pooling for Horizontal Wells: Can They Teach an Old Dog New Tricks?*, 55 ROCKY Mtn. MIN. L. INST. § 8.03 (2009) (articulating that the measure of damages for an improperly pooled unit is an undiluted share of the entire production of the horizontal well that traverses the tract in question); H. Philip 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, 204 (2011–2012) (explaining the lack of a pooling agreement could lead to the anomalous result that owners of tracts traversed by a horizontal well might be entitled to their full share of the production as if all the production had come from their individual tract as long as they could prove that some of the production did in fact come from their tract).

brought about by the absence of a judicially or legislatively articulated rule has led to the situation where operators are unable to determine, with any degree of certainty, their potential royalty liability when faced with such a scenario.<sup>380</sup>

As discussed above, the model put forth in House Bill 2087 represented an efficient solution to this vexing issue for all relevant stakeholders, and should be adopted. The law should not allow the absence of a determined legal rule to be exploited for the profit of these same interest owners.<sup>381</sup> The *Luecke* court had it right to the extent that the science of horizontally-drilled wells is different, and prior legal principles developed to serve a particular fact scenario should not be applied when the underlying fact scenario itself has changed.<sup>382</sup> Violation of this principle leads to prior established concepts compelling outcomes not intended by previous rulings.<sup>383</sup>

Rather than allow an NPRI holder to continue to expand influence over production decisions, which are by right the prerogative of the executive

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380. See H. Philip 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, 203 (2011–2012) (cautioning the law is unsettled as to the burden of proof an operator would have to meet in order to show that production did or did not come from a specific tract in a horizontal drilling operation); Allen D. Cummings, *Pooling and Community Leases: Problems and Options for the Executive Owner, the Non-Executive Owner and the Lessee*, in STATE BAR OF TEXAS, ADVANCED OIL, GAS & MINERAL COURSE, at I-36 (1997) (“However, there appears to be enough uncertainty about potential liability . . . to be an incentive for any lessee to take affirmative action to avoid problems arising from the pooling of non-|participating royalty interests.”); Jeffery L. Hart & J. Bruce Bennett, *Selected Pooling Issues*, in STATE BAR OF TEXAS, 27TH ANNUAL ADVANCED OIL, GAS, AND ENERGY RESOURCES COURSE 14 (Oct. 8–9, 2009) (“The lessee/operator can decide whether the partially unitized well is still economically viable with the additional royalty burden.”).

381. Most of the regulations issued by the Texas Railroad Commission are designed for vertical drilling and are not applicable to horizontal drilling. H. Philip 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, 182 (2011–2012). In addition, the law is not settled as to what actually constitutes interference with lessees’ rights. *Id.* at 202; *cf. id.* at 205 (“[T]here is no explicit Texas decision addressing the burden of proof issue for [drillsite] interests that have not agreed to a method of allocating production . . .”).

382. See *Luecke*, 38 S.W.3d at 645 (explaining geophysical characteristics of mineral formations preclude the use of the traditional rule of capture in horizontal drilling situations); *cf.* H. Philip 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, 178 (2011–2012) (noting courts and regulatory agencies have difficulty applying vertical drilling principles to horizontal drilling); Bruce M. Kramer, *Pooling for Horizontal Wells: Can They Teach an Old Dog New Tricks?*, 55 ROCKY MTN. MIN. L. INST. § 8.03 (2009) (“[M]ost pooling clauses contained in oil and gas leases were drafted with vertical well drilling in mind.”).

383. *Cf. Luecke*, 38 S.W.3d at 647 (refusing to apply vertical drilling principles to horizontal drilling activities).

and operator,<sup>384</sup> it is incumbent upon the courts, or the legislature, if necessary, to stand behind the spirit of *Luecke* and provide a bright-line rule in cases of non-consenting NPRI owners in a horizontally drilled unit with multiple drillsite tracts.<sup>385</sup> This will cause no harm. NPRI owners have an expectation of receiving a fractional share of the gross production obtained from the tract in which they own an interest.<sup>386</sup> They may choose to consent to the dilution of this fractional share when it is to their benefit (i.e., when their tract has been included in a community lease or leased through an agreement containing a pooling clause).<sup>387</sup> Likewise, NPRI owners may choose to refuse consent to pooling and take a full undiluted fractional share of gross production when the well is drilled on their tract.<sup>388</sup>

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384. See Christopher Kulander, *Big Money vs. Grand Designs: Revisiting the Executive Right to Lease Oil & Gas Interests*, 42 TEX. TECH L. REV. 33, 34 (2009) (“[T]he executive rights to lease have been defined by courts and treatises as the exclusive right to execute oil and gas leases.”); Allen D. Cummings, *Pooling and Community Leases: Problems and Options for the Executive Owner, the Non-Executive Owner and the Lessee*, in STATE BAR OF TEX., ADVANCED OIL, GAS & MINERAL COURSE, at I-3 (1997) (describing the various decisions over which an executive rights holder has dominion to the exclusion of a royalty interest holder). It is notable, however, that the executive rights holder does not have the power to change or diminish the interest of the royalty holder. *Brown v. Smith*, 174 S.W.2d 43, 46 (Tex. 1943).

385. See *Luecke*, 38 S.W.3d at 647 (determining vertical drilling principles are not appropriately applied to horizontal drilling operations).

386. See Christopher Kulander, *Big Money vs. Grand Designs: Revisiting the Executive Right to Lease Oil & Gas Interests*, 42 TEX. TECH L. REV. 33, 66 (2009) (“[T]he owner is not a necessary party to a lease of the mineral estate but rather only is entitled to an interest in ‘actual production’ once the minerals are severed.”); Allen D. Cummings, *Pooling and Community Leases: Problems and Options for the Executive Owner, the Non-Executive Owner and the Lessee*, in STATE BAR OF TEXAS, ADVANCED OIL, GAS & MINERAL COURSE, at I-2 (1997) (“A purchaser of a non[-]participating royalty interest contemplates receiving royalty from production, however, accrual of such royalty is completely dependent upon the actions of the holder of the executive rights in the lands burdened by the non[-]participating royalty interest.”).

387. See *Smith*, 174 S.W.2d at 46 (noting a pooling provision in a lease will allow the owners of multiple tracts to share the proceeds according to their acreage contributions); Christopher Kulander, *Big Money vs. Grand Designs: Revisiting the Executive Right to Lease Oil & Gas Interests*, 42 TEX. TECH L. REV. 33, 69 (2009) (“[A]n NPRI owner’s fractional interest in production is fixed . . . .”); Allen D. Cummings, *Pooling and Community Leases: Problems and Options for the Executive Owner, the Non-Executive Owner and the Lessee*, in STATE BAR OF TEX., ADVANCED OIL, GAS & MINERAL COURSE, at I-3 (1997) (listing the inclusion of a pooling clause in a mineral lease, the execution of a community lease, and the execution of a pooling agreement between the lessor and the lessee as the means by which pooling may be accomplished).

388. See Allen D. Cummings, *Pooling and Community Leases: Problems and Options for the Executive Owner, the Non-Executive Owner and the Lessee*, in STATE BAR OF TEX., ADVANCED OIL, GAS & MINERAL COURSE, at I-30 (1997) (“If the unit well is located on the burdened lands, then the non[-]participating royalty owner will probably want to decline to ratify either the lease or the unit, so that he can be paid his full non[-]participating royalty interest from the well, undiluted by the pooling.”); cf. Bruce M. Kramer, *Pooling for Horizontal Wells: Can They Teach an Old Dog New Tricks?*, 55 ROCKY

Absent a binding legal framework from the courts or legislature, it is not immediately clear who will bear the burden of paying excess royalties where multiple drillsite NPRI owners decline such consent.<sup>389</sup> Though the majority trend appears to indicate that the executive rights holder would be on the hook, Texas law is far from settled on this issue.<sup>390</sup> Texas courts have held that the executive owes a duty to the non-executive to notify of an attempted pooling, the breach of which could result in liability.<sup>391</sup> However, the courts have not ruled out the possibility that an operator could likewise be held liable for breach of duty.<sup>392</sup> This indicates

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MTN. MIN. L. INST. § 8.03 (2009) (indicating the measure of damages imposed when improper pooling has taken place is an award of an undiluted royalty on all production from the horizontal well); H. Philip 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, 204 (2011–2012) (explaining that absent a pooling agreement, each owner of a tract traversed by a horizontal well may be entitled to their full, undiluted share of the proceeds if they can prove some of the production came from their specific tract).

389. “[T]he burden is on the party comingling the goods to properly identify the share of each owner.” George A. Snell, III, *Non-Consenting Mineral Interests*, DALLAS ASS’N OF PROF’L LANDMEN, 34 (Sept. 10, 2007) (on file with the *St. Mary’s Law Journal*). It is possible that the operator/lessee could be liable for the excess royalties. See Allen D. Cummings, *Pooling and Community Leases: Problems and Options for the Executive Owner, the Non-Executive Owner and the Lessee*, in STATE BAR OF TEXAS, ADVANCED OIL, GAS & MINERAL COURSE, at I-18 (1997) (“Then the question is whether excess royalty is borne by the holder of the executive right or by the lessee.”); George A. Snell, III, *Non-Consenting Mineral Interests*, DALLAS ASS’N OF PROF’L LANDMEN, 34 (Sept. 10, 2007) (on file with the *St. Mary’s Law Journal*) (indicating because the operator is the party who is responsible for the comingling of the extracted minerals, and because it is difficult to determine how much of the production came from each tract, the operator may be liable to pay each owner as if the entire production came from his or her tract).

390. See *MCZ, Inc. v. Triolo*, 708 S.W.2d 49, 55 (Tex. App.—Houston [1st Dist.] 1986, writ ref’d n.r.e) (awarding attorney’s fees to the NPRI holder and declaring they be paid by the executive rights holder); Allen D. Cummings, *Pooling and Community Leases: Problems and Options for the Executive Owner, the Non-Executive Owner and the Lessee*, in STATE BAR OF TEXAS, ADVANCED OIL, GAS & MINERAL COURSE, at I-28 (1997) (commenting though it has been held the executive rights holder is liable for payment of excess royalties, language in another lease might lead to holding the lessee liable for the same excess royalty).

391. See *In re Bass*, 113 S.W.3d 735, 745 (Tex. 2003) (extending the duties owed by executive rights holders to NPRI holders to the level of fiduciary duties); Jeffery L. Hart & J. Bruce Bennett, *Selected Pooling Issues*, in STATE BAR OF TEXAS, 27TH ANNUAL ADVANCED OIL, GAS, AND ENERGY RESOURCES COURSE 16 (Oct. 8–9, 2009) (indicating the executive rights holder has a duty to the NPRI holders to protect their royalty interests). The executive rights holder may even be held to the standard of a fiduciary if his or her actions are later construed to be self-dealing. *Id.*

392. See Allen D. Cummings, *Pooling and Community Leases: Problems and Options for the Executive Owner, the Non-Executive Owner and the Lessee*, in STATE BAR OF TEXAS, ADVANCED OIL, GAS & MINERAL COURSE, at I-28 (1997) (explaining that while a Texas court has held an executive rights holder liable for excess royalties, the same court may hold a lessee liable under different facts); George A. Snell, III, *Non-Consenting Mineral Interests*, DALLAS ASS’N OF PROF’L LANDMEN, 34 (Sept. 10, 2007) (on file with the *St. Mary’s Law Journal*) (“Under the confusion of goods doctrine, the operator could be required to account to each of the separate tract owners as if 100% of the

at least a willingness on the part of the courts to impose excess royalty burdens on the operator.<sup>393</sup>

In the age of horizontal drilling, technology has once again outpaced legal concepts.<sup>394</sup> As legal practitioners struggle with the application of old law to new facts, the outcomes are often unsound.<sup>395</sup> In the previous age of vertical drilling, an operator could assess a prospect and gauge exposure to the risk of excess royalties with a fair amount of accuracy,<sup>396</sup> however, with the shift to horizontal wells and the trend towards expansive NPRI power, the application of old law to new facts creates an environment of uncertainty, within which an operator is unable to determine exposure to risk.<sup>397</sup> For example, in a field showing promise of prolific production, an operator developing vertical well prospects may well judge the risk of excess royalties from a single tract and determine that

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production came from each tract, unless the operator can show 'with reasonable certainty' how much production is obtained from each tract.')

393. See Allen D. Cummings, *Pooling and Community Leases: Problems and Options for the Executive Owner, the Non-Executive Owner and the Lessee*, in STATE BAR OF TEXAS, ADVANCED OIL, GAS & MINERAL COURSE, at I-28 (1997) ("Different lease language could result in the excess royalty burden being allocated to the lessee."); George A. Snell, III, *Non-Consenting Mineral Interests*, DALLAS ASS'N OF PROF'L LANDMEN, 34 (Sept. 10, 2007) (on file with the *St. Mary's Law Journal*) (describing the confusion of goods doctrine).

394. See 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, 216 (2002) ("However, with the rapid expansion of horizontal technology use, many of the legal concepts governing oil and gas law have failed to keep pace."). The rule of capture in particular is not applicable when apportioning royalty interests in horizontal wells. *Id.* at 252–53.

395. See *id.* at 251 (explaining the application of laws that were designed to govern vertical drilling to horizontal drilling is problematic). The *Luecke* court recognized that the law of capture in particular did not apply to horizontal well royalty disputes. *Id.* at 256; see also George A. Snell, III, *Non-Consenting Mineral Interests*, DALLAS ASS'N OF PROF'L LANDMEN, 31 (Sept. 10, 2007) (on file with the *St. Mary's Law Journal*) (describing the application of vertical drilling principles to horizontal drilling as "blatantly inappropriate").

396. See Allen D. Cummings, *Pooling and Community Leases: Problems and Options for the Executive Owner, the Non-Executive Owner and the Lessee*, in STATE BAR OF TEXAS, ADVANCED OIL, GAS & MINERAL COURSE, at I-18 (1997) (assessing the predicament of whether the executive right holder or the lessee should bear the burden of excess royalty); George A. Snell, III, *Non-Consenting Mineral Interests*, DALLAS ASS'N OF PROF'L LANDMEN, 34 (Sept. 10, 2007) (on file with the *St. Mary's Law Journal*) (indicating under the theory of comingling of goods an operator may be liable for excess royalty payments to tract owners).

397. See Allen D. Cummings, *Pooling and Community Leases: Problems and Options for the Executive Owner, the Non-Executive Owner and the Lessee*, in STATE BAR OF TEXAS, ADVANCED OIL, GAS & MINERAL COURSE, at I-29 (1997) (advocating that a lessee should take care in considering NPRI interests and assess their potential to lead to liability for excess royalties before developing a lease); H. Philip 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, 205 (2011–2012) (cautioning operators to investigate all the interests affected by a horizontal well for valid pooling or allocation agreements before beginning development of the well).

the potential risk exposure could be offset by outstanding production.<sup>398</sup> Such is not true with application of vertical well legal concepts to horizontal development, where the imposition of an additional 10–15% royalty burden could deal a crushing blow to the economics of the venture, no matter how outstanding the flow rates.<sup>399</sup>

The absence of a legal framework tailored to horizontal drilling acts as a strong disincentive for an operator faced with the prospect of developing a multi-tract prospect through horizontal development.<sup>400</sup> The non-participating royalty interest owner—by very definition a non-executive interest owner<sup>401</sup>—who has experienced expanded powers in recent years, is now able to exploit this vacuum of legal precedent to demand unmerited benefits or to exert influence over the development of oil and gas exploration in a manner not commensurate to the nature of the interest he or she holds.<sup>402</sup>

The courts and legislature have a duty to craft a system of laws that encourages the protection of private property rights, the efficient

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398. See Allen D. Cummings, *Pooling and Community Leases: Problems and Options for the Executive Owner, the Non-Executive Owner and the Lessee*, in STATE BAR OF TEXAS, ADVANCED OIL, GAS & MINERAL COURSE, at I-37 (1997) (declaring while it is possible for the NPRI interests in a vertical well to exceed to royalty interests therein, it is not probable).

399. See *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 635 (Tex. App.—Austin 2000, pet. denied) (noting while horizontal wells may produce more than vertical wells, they are two to three times more costly); Allen D. Cummings, *Pooling and Community Leases: Problems and Options for the Executive Owner, the Non-Executive Owner and the Lessee*, in STATE BAR OF TEXAS, ADVANCED OIL, GAS & MINERAL COURSE, at I-37 (1997) (commenting there is an increased potential for excess royalties in the context of horizontal drilling). The *Luecke* court also cautioned an operator should forego drilling unless he or she is able to find a solution beneficial to both the lessor and the lessee. *Luecke*, 38 S.W.3d at 647.

400. See *Luecke*, 38 S.W.3d at 647 (“[I]he prudent operator must seek to negotiate a solution mutually beneficial to both the lessee and the lessor or else forego drilling.”); Allen D. Cummings, *Pooling and Community Leases: Problems and Options for the Executive Owner, the Non-Executive Owner and the Lessee*, in STATE BAR OF TEXAS, ADVANCED OIL, GAS & MINERAL COURSE, at I-37 (1997) (noting it is possible all the NPRIs involved in a horizontal well would exceed the “total royalty reserved in the leases”); George A. Snell, III, *Non-Consenting Mineral Interests*, DALLAS ASS’N OF PROF’L LANDMEN, 34 (Sept. 10, 2007) (on file with the *St. Mary’s Law Journal*) (recognizing the rights of NPRI holders create uncertainty for operators).

401. See *MCZ, Inc. v. Triolo*, 708 S.W.2d 49, 52 (Tex. App.—Houston [1st Dist.] 1986, writ ref’d n.r.e) (defining an NPRI as an interest that does not carry with it the right of participation in bonuses or the right to execute lease agreements); George A. Snell, III, *Non-Consenting Mineral Interests*, DALLAS ASS’N OF PROF’L LANDMEN, 20 (Sept. 10, 2007) (on file with the *St. Mary’s Law Journal*) (confirming that an essential part of the definition of an NPRI holder is that such an owner does not have any right to execute mineral leases of his or her property).

402. Cf. *MCZ, Inc.*, 708 S.W.2d at 53 (describing the defendant’s argument that it would be unjust to pay excess royalty to NPRI holders to the detriment of executive rights holders).

utilization of resources, and the promotion of economic enterprise.<sup>403</sup> The absence of clear and reasonable rules to guide the operator faced with multiple tracts burdened by NPRIs in a proposed horizontal well development represents the failure of the legal community to ensure that evolving legal concepts keep pace with the activities they are meant to govern.<sup>404</sup> This is a problem with a solution that is within reach.

As it now stands, Texas oil and gas jurisprudence is in need of guidance on the issue of how to calculate NPRI amounts for non-consenting, non-executive owners. The best way to do provide such guidance is by adopting the formula set forth in House Bill 2087. This formula meets all the tenets of *Luecke*, and is both efficient and provides re-dress to any royalty owner that can prove he or she should be paid more.

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403. See *Luecke*, 38 S.W.3d at 646 (pointing to factors necessary for consideration in advancing this area of law); cf. 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, 225 (2009–2010) (recognizing that pooling protects the rights of mineral owners, prevents waste, and promotes efficient oil and gas production); James E. Key, *The Right to Royalty: Pooling and the Capture of Unburdened Interests*, 17 TEX. WESLEYAN L. REV. 69, 72 (2010) (“The purpose of pooling is to prevent the physical and economic waste that accompanies the drilling of unnecessary wells.”).

404. See 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, 216 (2002) (positing the law governing oil and gas has failed to keep up with the rapid pace of innovation in the horizontal drilling arena); cf. Bruce M. Kramer, *Pooling for Horizontal Wells: Can They Teach an Old Dog New Tricks?*, 55 ROCKY MTN. MIN. L. INST. § 8.03 (2009) (noting that most pooling clauses were drafted in expectation of vertical drilling, though they now may be applied in the context of horizontal drilling).