Nebraska Law Review

Volume 37 | Issue 2 Article 2

1958

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I. INTRODUCTION

Where, as in Nebraska, the legislation concerning the conservation of oil and gas is woefully inadequate,[1] the waste caused by competitive tract-by-tract development of oil and gas fields can be avoided only by voluntary agreement. Generally, voluntary agreements eliminate the competition and the waste caused thereby by effecting a combination of the opposing interests. This paper is intended to introduce the reader to some of the problems raised by those combinations.

To understand these problems, it is necessary to have a general knowledge of the relationship between an oil and gas lessor and his lessee. Generally, an interest in oil and gas in place is an interest in real property.[2] This interest is afforded the usual protection that real property interests receive, but with some modifications. The most important modifications result from the uniformly ac-

† For an excellent book upon which this paper relies heavily, the reader is referred to Leo J. Hoffman, Voluntary Pooling and Unitization (Matthew Bender & Company 1954).

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1 Four sections of the Nebraska Revised Statutes (Reissue of 1952) are concerned with the conservation of oil and gas. Section 57-215 authorizes the State Geologist to require, inter alia, ". . . (3) The drilling, casing, and plugging of wells in such manner as to prevent (a) the escape of oil or gas from one stratum to another, (b) the intrusion of water into oil or gas stratum, (c) the pollution of fresh water supplies by oil, gas, salt water, or brackish water, and (d) blow outs, explosions, and fires. . . ." Section 57-225 defines waste, and Section 57-226 provides that waste ". . . is hereby prohibited." Section 57-217 makes the violation of Section 57-215 a misdemeanor, but no penalty is provided for a violation of Section 57-226. For an interesting contrast see the discussion of the Oklahoma conservation legislation in Murphy, Conservation of Oil and Gas 369 et seq. (1949).

2 Sullivan, Handbook of Oil and Gas Law 41 (1955); 1 Summers, The Law of Oil and Gas 29 (Perm. Ed.).

cepted rule of capture and the equally well settled offset drilling rule. The former provides that the surface owner who extracts oil through his land owns that oil whether it originally underlaid his land or not.[3] The offset drilling rule limits the remedy of a landowner whose land is drained by another to the self-help relief he can achieve by drilling a well on his own property to intercept the oil before it is drained.[4] In practice, these rules result in intense competition among the surface owners for the oil which underlies their property in a common reservoir.

Because most surface owners have neither the funds nor the disposition to develop the oil or gas beneath their properties, they usually enter an agreement to have the property developed by others. The agreement takes the form of an oil and gas lease. It usually provides that the lessor shall receive ⅛ of the oil or gas that is produced from his land,[5] and that the lessee shall take the other ⅞. Sometimes it simply provides that the lessor shall be paid a certain sum of money for each well that the lessee drills.[6] In either case, the lessor is primarily interested in the early development of the property.

The lease may also provide for the term it is to run,[7] for the amount of delay rental the lessee must pay to keep the lease in

3 Westmoreland & Cambria Natural Gas Co. v. DeWitt, 130 Pa. St. 235, 18 Atl. 724 (1889); Elliff v. Texon Drilling Co., 146 Tex. 575, 210 S.W.2d 558, 4 A.L.R.2d 191 (1948); Sullivan, op. cit. supra, at 45; Hardwicke, The Rule of Capture and Its Implications as Applied to Oil and Gas, 13 Texas L. Rev. 391 (1935); Shank, Present Status of the Law of Capture, Sixth Annual Institute on Oil and Gas Law and Taxation, 257 (1955). (References to the Annual Institutes in this article refer to the Southwestern Legal Foundation Institutes.)

4 Barnard v. Monongahela Natural Gas Co., 216 Pa. 362, 65 Atl. 801 (1907); Sullivan, op. cit. supra note 2, at 46; 1 Summers, op. cit. supra note 2, at 161.

5 This fraction is called the royalty interest. In addition to it, the lessor may receive a "bonus" for signing the lease. Sullivan, Handbook of Oil and Gas Law 126 (1955); see also, State ex rel Fatzer v. Board of Regents, 176 Kan. 179, 269 P.2d 425 (1954); and Carroll v. Bowen, 180 Okla. 215, 68 P.2d 773 (1937).

6 This was customary in the earlier gas leases. However, it is becoming increasingly common to provide for royalty payments. Merrill, Covenants Implied in Oil and Gas Leases 16 (1940).

7 This is called the primary term. The lease will be extended beyond the primary term when and so long as production is obtained in paying quantities. Sunburst Oil and Refining Co. v. Callender, 84 Mont. 178, 274 Pac. 834 (1929); Litten v. Geisler, 80 Ohio App. 491, 76 N.E.2d 741 (1947); Hennessy v. Junction Oil and Gas Co., 75 Okla. 220, 182 Pac. 666 (1919); Garcia v. King, 139 Tex. 578, 164 S.W.2d 509 (1942).

force without drilling,[8] for the surrender of all or part of the lease,[9] for the use that may be made of the surface, and for infinite other details.[10] However, the majority of leases fail to prescribe the extent of the exploration, development, operation, protection against drainage, and the diligence with which these shall be carried on.[11] Thus, the determination of those matters is left to the courts' construction of the lease.

This judicial construction has established that certain covenants are implied in the lease. One of these is the implied covenant to drill an exploratory well.[12] This covenant may be satisfied by the payment of delay rentals.[13] Another is the implied covenant to reasonably develop the lease by the drilling of additional wells.[14] A third is the implied covenant "for diligent and proper operation,"[15] or "to diligently operate and market."[16] A fourth is the

[8] Two types of clauses are common. One provides that the lessee must drill *or* pay delay rentals after a specified date. The other provides that if no well is commenced by a specified date the lease will terminate *unless* the lessee pays delay rentals. The *unless clause* will cause an automatic forfeiture if the lessee neither drills nor pays. The lessee's inaction under an *or clause* amounts to the breach of a condition subsequent and affirmative action by the lessor is necessary to terminate the lease. Sullivan, Handbook of Oil and Gas Law 104-106 (1955); see also McElroy, Unless vs. Or: An Appraisal, 6 Baylor L. Rev. 415 (1954); and Braly, Problems Presented by Operations During The Primary Term of an Oil and Gas Lease, Sixth Annual Institute on Oil and Gas Law and Taxation, 189 (1955).

[9] Typically, the clause provides: "Lessee may at any time surrender this lease in whole or in part, by delivering or mailing a release thereof of record in the proper county." Sullivan, Handbook of Oil and Gas Law 196 (1955). See Rhoads Drilling Co. v. Allred, 70 S.W.2d 576 (Tex. Civ. App. 1934); McKee v. Grimm, 111 Okla. 24, 238 Pac. 835 (1925).

[10] For example, the lease may provide that the lessee may not drill within a specified radius from a dwelling, that the lessee must pay for any damage to growing crops, and that the lessee must bury all pipe lines below plow depth. Sullivan, Handbook of Oil and Gas Law 156-157 (1955). See also Terry, Miscellaneous Clauses in Oil and Gas Leases, Second Annual Institute on Oil and Gas Law and Taxation, 237 (1951).

[11] Merrill, Covenants Implied in Oil and Gas Leases 20 (1940).

[12] State ex rel Commissioners v. Couch, 298 P.2d 452 (Okla. 1956); Witt v. Westheimer, 182 Okla. 645, 79 P.2d 250 (1938); McKee v. Thornton, 79 Okla. 138, 192 Pac. 212 (1920); Merrill, Covenants Implied in Oil and Gas Leases 48 (1940).

[13] Sullivan, Handbook of Oil and Gas Law 168 (1955).

[14] Burnett v. R. Lacy, Inc., 293 S.W.2d 674 (Tex. Civ. App. 1956); Link v. State's Oil Corp., 229 S.W. 693 (Tex. Civ. App. 1921); 2 Summers, The Law of Oil and Gas 311 (Perm. Ed.); Merrill, Covenants Implied in Oil and Gas Leases 128 (1940).

[15] Merrill, Covenants Implied in Oil and Gas Leases, 182 (1940).

[16] Sullivan, Handbook of Oil and Gas Law 173 (1955).

implied covenant to protect the premises against drainage.[17]

In addition to setting the relationship between the lessee and his lessor,[18] the implied covenants operate to put lessees vis-a-vis lessees in the same competitive position as their lessors.[19] Because of this competition,

> . . . each new pool was drilled and exhausted as rapidly as was physically possible in the effort by each producer to get his oil to the surface and reduced to possession, whether or not a market existed for the oil. Waste was inherent in the manner of production and was inevitable, both underground and at the surface. Oil that could not be absorbed by current demands had to be stored, usually for a long period, and frequently in earthen pits. Fire, leakage, evaporation, and deterioration took a severe toll. Prices were periodically depressed to absurdly low levels, business and employment were disrupted, and cheap oil was squandered. Underground loss of oil was tremendous, for only that oil was recovered that would flow readily into a well under immediate available underground forces, the remainder being left in the ground. The natural gas associated with the oil was blown to the atmosphere and burned, for conditions did not permit its recovery and utilization. . . .[20]

II. THE COMMUNITY LEASE

In one fact situation, the implied covenants virtually force the lessee into competition with himself. This occurs when the lessee obtains separate leases from the respective owners of contiguous tracts. If the lessee obtains production on one tract and drains the hydrocarbons underlying both tracts, it is not unlikely that both lessors will seek to share in the production. The owner of the well tract is, by the express terms of his lease, entitled to the full royalty on all of the production.[21] The owner of the non-well tract is en-

[17] Blake v. The Texas Co., 123 F.Supp. 73 (E.D. Okla. 1954); Hay v. Shell Petroleum Co., 30 F.Supp. 663 (W.D. Okla 1939); Poindexter v. Lion Oil & Refining Co., 205 Ark. 978, 167 S.W.2d 492 (1943); Ramsey Petroleum Corp. v. Davis, 184 Okla. 155, 85 P.2d 427 (1938); Sullivan, Handbook of Oil and Gas Law 176 (1955).

[18] For an article dealing with the relationship between language in the lease and the implied covenants see Merrill, Lease Clauses Affecting Implied Covenants, Second Annual Institute on Oil and Gas Law and Taxation, 141 (1951).

[19] The lessee is held either to the standard of "the reasonably prudent operator" or to a standard of "good faith." The first requires him to do what an ordinary prudent operator would do; the second leaves the determination of what to do entirely to the lessee, providing that he acts in good faith. Shell Oil Co. v. Howell, 208 Okla. 598, 258 P.2d 661 (1953); Ramsey Petroleum Corporation v. Davis, 184 Okla. 155, 85 P.2d 427 (1938).

[20] Buckley, Petroleum Conservation 8 (1951).

[21] See note 5, supra.

titled to the protection of the implied covenant to prevent drainage.[22] Therefore, the lessee must drill an offset well, compensate the non-well tract owner by the payment of damages,[23] or suffer the termination of his lease on the non-well tract.[24]

It is now common practice for lessees to seek to avoid that situation by having the owners of contiguous tracts jointly execute one lease that describes both of their tracts as a whole. The usual lease, so executed, then becomes a community lease.[25] The important differences between the usual lease and the community lease are, first, that the property description in the community lease includes land that is separately owned by two or more persons, and second, that those separate owners are collectively described as the lessor in the community lease. The important similarities between the two leases are that both provide that the production from any part of the described tract will stop the requirement for delay rentals and extend the lease beyond the primary term.[26] Both also provide that the royalties will be paid to those who are collectively described as the lessors.

A. The Effect of a Community Lease

By obtaining a community lease from the owners of contiguous tracts, the lessee insures that he will have to pay the specified royalties, and no more,[27] on any production that is obtained from

22 However, in this fact situation compliance with the prudent operator or good faith tests, supra note 19, will not relieve the lessee of liability, for he is bound by an implied covenant to do nothing to impair the value of the lease. Phillips Petroleum Co. v. Millette, 221 Miss. 1, 72 So.2d 176 (1954); Carper v. United Fuel Gas Co., 78 W.Va. 433, 89 S.E. 12 (1916).

23 The damages may be measured by the cost of an offset well, Fite v. Miller, 192 La. 229, 187 So. 650 (1939); or the amount of royalties that the lessor would have received if the well had been completed. Waldrip v. Hamon, 136 F. Supp. 412 (E.D. Okla. 1955); see also Symposium on the Oklahoma Law of Damages, 6 Okla. L. Rev. 289, 358 (1953); and Hart, Damages and Other Relief for Breach of Express and Implied Covenants in Oil and Gas Leases and Drilling Agreements, Seventh Annual Institute on Oil and Gas Law and Taxation 47 (1956).

24 If an implied covenant is given the force of a condition, the alternative of damages or termination rests with the lessor. Four Brotherhood Oil Co. v. Kelly, 235 S.W. 604 (Tex. Civ. App. 1921).

25 The term community lease is preferred to the term joint lease because the latter can as well signify any lease in which two or more mineral owners join, including ordinary co-tenants in a unified tract of land. Hoffman, Voluntary Pooling and Unitization 9 (1954).

26 See notes 7 and 8, supra.

27 Note particularly that the lessee will save the expense of offset wells and that he will not be required to share this saving with the lessors.

either tract. He also insures that production from either tract will continue the lease as to both tracts. Thus, the relationship between the lessee and his lessors under a community lease is identical to the relationship between the lessee and the lessor of the usual oil and gas lease.

B. The Intention to Share

However, the relationship between the lessors is usually not expressed in the community lease. Thus, when the lessee obtains production on only one of the communitized tracts, the question of whether the owner of the non-well tract should be allowed to participate in that production is left for the courts. All of the jurisdictions which have dealt with this question agree that the answer is a function of the lessors' intention, and it is uniformly recognized that an express provision in the lease will be controlling.[28]

When the parties have not expressed a contrary intention, three factors weigh heavily in favor of sharing. First, in the ordinary commercial transaction, it may reasonably be presumed that the parties intended their execution of a community lease to have a different effect than the execution of separate leases. Second, the owner of the non-well tract, bound by the terms of the lease,[29] would receive no income from that lease unless he was entitled to participate in the production from the well tract or production was subsequently obtained upon his tract. Third, under a rule of non-sharing, the interests of the well tract owner would be as adverse to the interests of the non-well tract owner as they would have been if a community lease had not been executed. This would make it difficult for them to agree that further exploration and development was or was not prudent and would hinder their enforcement of the express and implied covenants.

The majority of jurisdictions follow these factors to their extreme and hold that the execution of a community lease gives rise to a conclusive presumption that the parties intended to share the production.[30] Although this rule may not give effect to the in-

[28] Hoffman, op. cit. supra note 25, at 10.

[29] The development of either tract keeps the lease alive as to the other. Nabors v. Producers' Oil Co., 140 La. 985, 74 So. 527 (1917). See also McCammon v. The Texas Co. 137 F. Supp. 256 (D. Kan. 1954).

[30] Petroleum Midway Co. v. Moynier, 205 Cal. 733, 272 Pac. 740, 743 (1928); Higgins v. California Petroleum and Asphalt Co., 109 Cal. 304, 41 Pac. 1087 (1895); French v. George, 159 S.W.2d 566 (Tex. Civ. App. 1942); Parker v. Parker, 144 S.W.2d 303 (Tex. Civ. App. 1940); Hamilton v. McCall Drilling Co., 131 W.Va. 750, 50 S.E.2d 482 (1948); Lynch v. Davis, 79 W.Va. 437, 92 S.E 427 (1917).

tention of the parties in a particular case, it is laudable from the title examiner's viewpoint; for, when consistently followed, it has the finality of a rule of property. Furthermore, once it is so established, this rule gives the community lease a definite legal effect that all property owners may be presumed to know.

Oklahoma has not gone that far. Its rule is that the community lease gives rise to a rebuttable presumption that the lessors intended to share the production.[31] This presumption may be rebutted by the terms of the lease, by other oral or written agreements, or by the conduct of the lessors. This rule is more likely to give effect to the intention of particular lessors, but it does not give the subsequent purchaser of one of the communitized tracts the assurance that is afforded by the majority rule.

Only one case seems to have accepted the antithesis of either the majority rule or the Oklahoma rule.[32] That is *Lusk v. Green,*[33] in which the Oklahoma court apparently held that a bare community lease to non-contiguous tracts gives rise to a presumption that the parties did not intend to share the production from either tract.[34] However, the Louisiana court came very close to adopting the alternative that a community lease gives rise to neither a presumption that the parties intended to share nor a presumption that they did not intend to share.[35] Such a rule may seem reasonable on its face, but its practical effect makes it untenable. To illustrate, assume that the lessee paid all of the royalties from community lease production to the owner of the well tract. If the owner of the non-well tract wished to participate in that production and the lease did not give rise to either presumption, he would have to allege an intention to share in addition to the existence of the lease in order to state a cause of action. Having alleged the intention to share, he would have the burden of proving that fact. If

[31] Peerless Oil & Gas Co. v. Tipken, 190 Okla. 396, 124 P.2d 418 (1942).

[32] However, in another fact situation the majority of courts employ the opposite reasoning. Thus, where land is subdivided subject to an existing lease it is generally held that, in the absence of an agreement to the contrary, production from any of the subdivided tracts shall not be apportioned among the other tracts. Galt v. Metscher, 103 Okla. 271, 229 Pac. 522 (1923); Japhet v. McRae, 276 S.W. 669 (Tex. Com. App. 1925); Walker v. West Virginia Gas Corp., 121 W.Va 251, 3 S.E.2d 55 (1939).

[33] 114 Okla. 113, 245 Pac. 636 (1926).

[34] Unless it can be distinguished from *Peerless Oil & Gas Co. v. Tipken,* supra note 31, on the ground that it considered a community lease to *non-contiguous* tracts, *Lusk v. Green* does not state the current Oklahoma rule.

[35] Louisiana Canal Co. v. Heyd, 189 La. 903, 181 So. 439, 116 A.L.R. 1260 (1938).

there was no evidence of the lessors' intention other than the language of the community lease, or if the additional evidence did not preponderate in favor of either intention, he would not be entitled to share. Note, however, that if the lessee had allocated the proceeds between the owners of both tracts and the well tract owner had alleged an intention not to share, the result on the same facts would have been the opposite, and the non-well tract owner would have been entitled to share. Therefore, under the alternative rule that a community lease gives rise to neither presumption, the result in a given case may turn upon the lessee's fortuitous payment to the well tract owner or to the owners of both tracts.[36] Thus to use this alternative is to dispose of the policy considerations by disregarding them.[37]

Furthermore, it should be noted that several fact situations may arise in which evidence of the lessors' intention is quite scarce. Three examples which have been litigated follow. First, in *Louisiana Canal Co. v. Heyd*,[38] Heyd sold part of his land to the plaintiff and then executed a lease which described the entire tract. Plaintiff ratified the lease by accepting delay rentals from the lessee. The court held that "... the contract became a joint lease by plaintiff's acceptance of it and that *the parties intended* to pool their interests. . . ." (Emphasis supplied.)[39] Second, in *Irick v. Hubbel*,[40] plaintiff and several other tract owners each executed separate but identical leases which described the entire acreage owned by them. Plaintiff was asked to sign a separate unitization agreement, but she refused. Plaintiff brought an action to obtain the full royalty from production on her tract, and testified ". . . that she never had any conversation with defendants about the well or made any agreement with the other owners of mineral interests under the 80-acre tract described in the lease. . . ."[41] The court relied upon the rebuttable presumption rule of the *Peerless*[42] case and held that the lessors intended to share in the production as ". . . plaintiff made no proof of any agreement or expressed

[36] Cf. Clark v. Elsinore Oil & Refining Co., infra note 48, where action of the lessee was held to have no effect on the lessors' intention.

[37] See Professor Stone's discussion of "The Legal Category of Meaningless Reference." Stone, The Province and Function of Law 171 (1950).

[38] Supra, note 35.

[39] 181 So. at 445.

[40] 280 P.2d 733 (Okla. 1955).

[41] 280 P.2d at 734.

[42] Peerless Oil & Gas Co. v. Tipken, supra note 31.

intention between the lessors to the contrary."[43] Third, in *Ward v. Golke*,[44] a widow executed an oil and gas lease which described four tracts. In three of the tracts she held an undivided one-half interest and a life estate in the remaining one-half interest. In the fourth tract she had a life estate. She was joined in this lease by the remaindermen who were to take after the expiration of her life estates. Production was obtained on the fourth tract. At the widow's death, the remaindermen of the fourth tract brought an action to recover the full amount of the royalties. The Texas court applied its standard rule that the joint execution of a lease compels the sharing of production.[45]

In each of those cases the courts were able to reach a result which is equitable from the objective point of view without benefit of evidence which preponderated toward either intention of the lessors. The achieving of such a result would not have been so easy under the alternative rule that the lease gives rise to neither presumption.

C. THE BASIS OF PARTICIPATION

By deciding that the lessors in a given case intend to share the production from any part of a community lease, the courts necessarily raise the question of the basis of that participation. Did the parties intend to share on the basis of their contributed surface acreage, on the basis of the relative value of their tracts, or on the basis of some combination of these factors? Where a contrary intention is not expressed, the courts uniformly hold that the parties intended to share on the basis of their contributed surface acreage.[46]

This basis may be easily and accurately applied, but it bears only a coincidental and improbable relationship to the value of the tracts or the result that the parties probably would have agreed to if they had known that relative value. For example, assume

[43] 280 P.2d at 735.

[44] 279 S.W.2d 422 (Tex. Civ. App. 1955).

[45] See also Langrebe v. Rock Hill Oil Co., 273 S.W.2d 636 (Tex. Civ. App. 1954).

[46] Petroleum Midway Co. v. Moynier, 205 Cal. 733, 272 Pac. 740 (1928); Peerless Oil & Gas Co. v. Tipken, 190 Okla 396, 124 P.2d 418 (1942); French v. George, 159 S.W.2d 566 (Tex. Civ. App. 1942); Hamilton v. McCall Drilling Co., 131 W.Va. 750, 50 S.E.2d 482 (1948). But see Higgins v. California Petroleum and Asphalt Co., 109 Cal. 304, 41 Pac. 1087 (1895), which holds that the apportionment should be on a "comparative value" basis. This case has never been followed on this point. Hoffman, Voluntary Pooling and Unitization 30 (1954).

that A and B, who severally own contiguous forty acre tracts, join in a community lease which describes both tracts. Assume further that only twenty of their eighty acres overlie economically recoverable oil or gas. Depending on where that twenty acres lies relative to the surface property lines, the application of the acreage basis fortuitously allocates an undue share to A, an undue share to B, or the proper share to each.

Moreover, the courts hold that the participation of each lessor is determined by the amount of acreage he originally contributes. Therefore, when the lessee surrenders[47] part of one of the tracts, the owner of that tract is still entitled to participate on the basis of the amount of acreage he had originally contributed.[48] Furthermore, he will be entitled to that participation even though he subsequently obtains production on the surrendered acreage in which the other community lessors are not entitled to participate.[49]

D. THE CROSS-CONVEYANCING DOCTRINE

If the potential litigation of the issue of the parties' intention to share and the possible inequitable effect of acreage basis sharing are not enough to deter lessors from signing community leases, the cross-conveyancing doctrine should be. Under that doctrine the act of entering a community lease effects a cross-conveyance of the lessors' royalty interest so that each becomes a joint tenant in the unitized whole.[50]

This doctrine is an extension of the majority rule that the intent to share will be conclusively presumed from a community lease which does not contain an express provision to the contrary.[51] For that reason it is noteworthy that the cross-conveyancing doctrine and the conclusive presumption have opposite effects on titles to property. The conclusive presumption tells the title examiner that the royalty owner of each tract has the right to share in the unitized production; but the cross-conveyancing doctrine puts the ownership of each royalty interest in all of the lessors, even though

47 See supra, note 9.

48 Clark v. Elsinore Oil Co., 138 Cal.App. 6, 31 P.2d 476 (1934); and see First National Bank of Redondo v. Standard Oil Co., 91 Cal.App. 705, 267 Pac. 548 (1928) where the lease expressly provided that participation would continue after surrender.

49 Tanner v. Olds, 29 Cal.2d 110, 173 P.2d 6 (1946); Tanner v. Title Insurance and Trust Co., 20 Cal.2d 814, 129 P.2d 383 (1942).

50 Hoffman, Voluntary Pooling and Unitization 102 (1954).

51 Veal v. Thomason, 138 Tex. 341, 159 S.W.2d 472 (1942).

one or more of them may have had defective titles.[52] Thus, on the one hand, all of the unitized lessors will be necessary parties to an action to try title to the royalty interests of any one of the tracts,[53] and, on the other hand, the grantee in a conveyance which describes only one of the tracts will not be entitled to participate in production from any of the other tracts.[54] Presumably, this rule will also apply to devisees who take a described tract subsequent to its inclusion in a community lease.[55] Therefore, when the royalty interest in a communitized tract is to be conveyed, that interest must be described with great care, and the description must not be limited to the legal description of the tract.

E. Effect in Nebraska

The Nebraska Supreme Court has not decided a case concerning community leases. Therefore, the execution of such a lease in this State remains an open invitation to extensive litigation among lessors, their heirs, and their assigns. In light of the *Heyd*[56] and *Irick*[57] cases, this litigation will be avoided only if all lessors refuse to execute any lease which describes more land than they are individually entitled to lease unless that lease carefully expresses the intention of the lessor.

III. THE POOLING CLAUSE

Competitive tract-by-tract development may also be arrested by the use of the pooling clause that is contained in the usual oil and gas lease. In its simplest form, this clause provides that the lessee shall have the power to pool all or any part of the leased

[52] Gillis v. Royalty Service Corp., 91 Cal.App.2d 365, 204 P.2d 968 (1949).

[53] Belt v. The Texas Co., 175 S.W.2d 622 (Tex. Civ. App. 1943); Veal v. Thomason, 138 Tex. 341, 159 S.W.2d 472 (1942). Compare, Douglas v. Butcher, 272 S.W.2d 553 (Tex. Civ. App. 1954); Sohio Petroleum Co. v. Jurek, 248 S.W.2d 294 (Tex. Civ. App. 1952).

[54] Boren v. Burgess, 97 F. Supp. 1019 (E.D. Okla. 1951); Tanner v. Title Insurance Co., 20 Cal.2d 814, 129 P.2d 383 (1942).

[55] But cf. Long v. Knox, 291 S.W.2d 292 (Tex. 1956), where the heir of a community lessor was entitled to share under a clause in the lease which provided that "all royalties occurring thereunder shall be treated as an entirety and shall be divided among and paid to the separate owners" on the acreage basis. See also Hardwicke and Hardwicke, Apportionment of Royalty to Separate Tracts: The Entirety Clause and Community Lease, 32 Texas L. Rev. 660, 2 Oil and Gas Law from the Texas Law Review 2018 (1954).

[56] Louisiana Canal Co. v. Heyd, supra, note 35.

[57] Irick v. Hubbel, supra, note 40.

premises with other tracts. Usually, however, the pooling clause goes on to provide that for all purposes except the determination of royalties production on any of the pooled tracts shall constitute production on the leased premises, and that the proceeds of any production will be allocated on a specified basis.[58] It may also limit the total number of acres that may be pooled.[59]

By interpretation, the courts have further restricted the operation of the pooling clause. For example, the lessee must exercise good faith,[60] and cannot, therefore, pool productive land with land that is known to be unproductive.[61] Also, he may pool the leased premises only if the lessors of all of the tracts involved have given him similar authority.[62]

The pooling clause must be definite enough to meet the usual contract law standard of definiteness. In addition, in those states which accept the cross-conveyancing doctrine, it must be definite enough to meet the standard of the rule against perpetuities. The latter problem has been raised by lessors who were seeking to avoid the effect of pooling. They have argued that since under the cross-conveyancing doctrine pooling constitutes a conveyance of an interest in land, the pooling clause establishes a power to convey an interest in land. If, as is usual, the pooling clause does not contain a restriction as to time, it follows that it is void under the rule against perpetuities. The courts have two answers to this argument. The first is that the interests vest immediately upon the execution and delivery of the lease.[63] The second is that the power to pool must be exercised within a reasonable time, which is *a priori* within the time limit of the rule against perpetuities.[64] Under these theories the problem of remoteness in so far as it concerns pooling clauses has been pretty well laid to rest.

However, the other problems raised by the cross-conveyancing doctrine of community leasing may apply with full vigor to units

[58] Sullivan, Handbook of Oil and Gas Law 150 et seq. (1955).

[59] Hoffman, Voluntary Pooling and Unitization 89 (1954).

[60] Boone v. Kerr-McGee Oil Industries, 217 F.2d 63 (10 Cir. 1954); Phillips Petroleum Co. v. Peterson, 218 F.2d 926 (10 Cir. 1954), *cert. denied,* 349 U.S. 947 (1955).

[61] Imes v. Globe Oil and Refining Co., 184 Okla. 79, 84 P.2d 1106 (1938).

[62] Viator v. Haynesville Mercantile Co., 230 La. 132, 88 So.2d 1 (1956); Union Oil Co. v. Touchet, 229 La. 316, 86 So.2d 50 (1956).

[63] Kenoyer v. Magnolia Petroleum Co., 173 Kan. 183, 245 P.2d 176 (1952).

[64] Phillips Petroleum Co. v. Peterson, 218 F.2d 926 (10 Cir. 1954).

created by the pooling clause.[65] Thus, in jurisdictions which accept the cross-conveyancing doctrine, if the lessor is to know the status of his title he must insist that the pooling clause contain an express provision that he does not intend to give the lessee power to convey all or any part of his mineral interests.

Similarly, if the lessor wishes to avoid the possible hardships of the acreage basis of allocating unit production, he must insist that a more equitable basis be expressed in the pooling clause.

In addition, if the pooling clause purports to give the lessee power to pool *all or any part* of the leased premises, the lessor should demand expression of the effect that a partial pooling will have on the unpooled part of the leased premises. Otherwise, he may find that the usual pooling clause provision that production from the unit has the same effect as production from the leased premises applies with full strength to the unpooled part of his land.[66] In such a case all of his leased acreage would be bound by production on the unit, but he would be entitled to participate in that production only to the extent that his acreage contributed to it.

There is a distinct possibility that the lessor may not be able to effectively write all of the foregoing restrictions into the pooling clause. For example, a restriction as to the basis of his participation may, in light of the rule that all pooled leases must grant similar authority, prove too restrictive to be workable. Furthermore, even if the lessor's scrivener can foresee and provide for all of the multilateral problems without benefit of the other lessors' points of view, his draft of the pooling clause may become too unwieldy to be used in the lease. Therefore, the safer,[67] more practicable alternative

[65] Some doubt is cast upon this premise by Sohio Petroleum Co. v. Jurek, 248 S.W.2d 294(Tex. Civ. App. 1952) and Fussell v. Rinque, 269 S.W.2d 442 (Tex. Civ. App. 1954). The *Jurek* case held that the cross-conveyancing doctrine did not apply to its facts. The *Fussell* case relied upon *Jurek* and held that the owners of all tracts were not necessary parties in an action to try title to one of several tracts which had been pooled pursuant to a pooling clause. However, sufficient doubt exists to warrant the conclusion in the text.

[66] Scott v. Pure Oil Co., 194 F.2d 393 (5 Cir. 1952); Gray v. Cameron, 218 Ark. 142, 234 S.W.2d 769 (1951); LeBlanc v. Danciger Oil & Refining Co., 218 La. 463, 49 So.2d 855 (1950).

[67] To the effect that the acceptance of royalties determined on the pooled basis will constitute a binding ratification of the pooling see Leopard v. Standard Oil & Gas Co., 220 S.W.2d 259 (Tex. Civ. App. 1949); Merrill Engineering Co. v. Capital National Bank of Jackson, 192 Miss. 378, 5 So.2d 666 (1942); and Dobbins v. Hodges, 208 La. 143, 23 So.2d 26 (1945).

is to reject the pooling clause in favor of a separate unitization agreement.

IV. THE SEPARATE AGREEMENT

As a third alternative to competitive tract-by-tract development, the parties may enter an agreement that is separate from the lease and which provides that the reservoir will be developed according to its terms. Such agreements are governed by the usual rules of contract law.[68]

Like most commercial contracts, separate agreements are tailored to meet the desires of the parties as dictated by their particular circumstances. Hence, the terms of these agreements vary from reservoir to reservoir, and there is no standard form for them. However, all of them are intended to eliminate the waste caused by competitive tract-by-tract development. They accomplish this end by offering the opportunity to conserve the natural reservoir energy, and, thereby, achieve the maximum primary recovery.[69] Similarly, they offer the opportunity to increase recovery by secondary[70] or tertiary techniques.[71] In addition they offer the opportunity to eliminate unnecessary wells and storage facilities and, thereby, decrease the costs of production.

Generally, separate agreements may be divided into two categories: (1) those under which each tract is developed individually according to specified standards, and (2) those under which all of the tracts are developed as a whole.

An agreement of the first type that is in common use among lessees is the contribution agreement. It usually takes the form of a "bottom hole letter" or a "dry hole letter."[72] In the former, lessee A agrees to pay a specified sum of money to lessee B, if B will complete a well of prescribed depth on B's lease and furnish geological data to A. The "dry hole letter" is similar, except that A agrees to pay only if B does not discover oil or gas in production

[68] Dobbins v. Hodges, supra, note 67; Duff v. DuBose, 27 S.W.2d 122 (Tex. Civ. App. 1930).

[69] Murray, Engineering Aspects of Unit Operation, Third Annual Institute on Oil and Gas Law and Taxation 1,2 (1952).

[70] For a brief discussion of the methods of increasing production by the secondary recovery techniques of injecting gas, water, or oil into the reservoir see Sullivan, Handbook of Oil and Gas Law 30 (1955).

[71] Tertiary recovery methods involve the injection into the reservoir of new substances and forces. Voorhees, Techniques of Field Wide Unitization 24 Rocky Mt. L. Rev. 14, 15 (1951).

quantities.[73] This type of agreement spreads the economic risk of the driller's well and provides the other lessees with information indicative of the size of their risks. However, it does not spread the risk of drilling subsequent wells. Furthermore, the successful completion of a producing well imposes the duty to competitively develop their tracts on both the drilling and the non-drilling parties to the agreement. At best, then this type of agreement can only postpone the beginning of competitive development.

The lessees may lessen their competition by agreeing, among themselves, to a specified spacing of wells, a specified rate of withdrawal of hydrocarbons from a common reservoir, to the use of specified wells for injection purposes, and so on. However, these agreements may violate one or more of the implied covenants.[74] Therefore, it is necessary to have the lessors join in these agreements if they are to be effective.

When the lessors do join in this type of agreement, they waive compliance with so much of their leases as is affected by the agreement. Still, they are entitled to the individual development of their tracts.[75] Thus, between the parties, this type of agreement has much the same effect as conservation legislation.

The second type of agreement, in which all of the tracts are developed as a whole, has a broader affect on the interested parties. This type of agreement affords the opportunity for complete elimination of competitive waste by collecting all of the individual royalty interests and allowing them to be developed by one collective working interest. From the engineering point of view, the result is much the same as if one person owned all of the surface acreage overlying a particular reservoir.[76]

The legal affect of this type of agreement is more complex. Like the first type of agreement, it will not bind those lessors who

[72] Sullivan, Handbook of Oil and Gas Law 525 (1955). See also Brown, Assignments of Interests in Oil and Gas Leases, Farm-Out Agreements, Bottom Hole Letters, Reservations of Overrides and Oil Payments, Fifth Annual Institute on Oil and Gas Law and Taxation 25 (1954).

[73] Sullivan, op. cit. supra note 72, 525.

[74] Ramsey v. Carter Oil Co., 74 F.Supp. 481 (E.D. Ill. 1947); *aff'd,* 172 F.2d 622 (7th Cir. 1949); *cert. denied,* 337 U.S. 958. Cf. Carter Oil Co. v. Dees, 340 Ill.App. 449, 92 N.E. 519 (1950).

[75] Sullivan, Handbook of Oil and Gas Law 359 (1955).

[76] See Murray, op. cit. supra, note 69.

are not parties to it.[77] Furthermore, the consent of a partial-royalty owner who has the power to lease will not bind the partial-royalty owner in the same tract who does not have the power to lease.[78] The unit will not fail because all of the royalty owners do not agree to it,[79] but the non-joiners will be entitled to full compliance with the terms of their leases, including full royalty on all hydrocarbons which are produced from their tracts.[80] Therefore, all interested lessors will normally be asked to join in the proposed unit.

The agreement that the lessor will usually be asked to sign is called a royalty owners' agreement. His lessee will normally execute a separate working interest agreement.[81] Because the lessees' agreement contains much information that need not concern the lessor,[82] the discussion which follows considers lessees' agreements only incidentally.

A. CONTENT

Basically, the royalty owners' agreement provides that each royalty owner agrees to have his tract developed as a part of a specified area in accordance with the terms of the working interest agreement, and that he is to receive a particular share of the proceeds of the unit.

In agreeing to have his land developed as a part of the unit, the royalty owner agrees that the terms of his lease shall be modified. This is usually accomplished by an expression in the unitization

77 Bruce v. Ohio Oil Company, 169 F.2d 709 (10th Cir. 1948), *cert. denied,* 336 U.S. 913 (1949); Carter v. Arkansas-Louisiana Gas Co., 213 La. 1028, 36 So.2d 26 (1948); Hood v. Southern Production Co., 206 La. 642, 19 So.2d 336 (1944); Knight v. Chicago Corp., 144 Tex. 98, 188 S.W.2d 564 (1945).

78 Brown v. Smith, 141 Tex. 425, 174 S.W.2d 43 (1943), holds that a non-participating royalty owner is not bound by a community lease which he does not sign, even though he would be bound by an ordinary lease which was executed by the participating royalty owner.

79 Pinchback v. Gulf Oil Corporation, 242 S.W.2d 242 (Tex. Civ. App. 1951); Smith Petroleum Co. v. Van Mourik, 302 Mich. 131, 4 N.W.2d 495 (1942). See also Bruce v. Ohio Oil Company and Knight v. Chicago Corp., cited in note 72, supra.

80 Smith Petroleum Co. v. Van Mourik, supra, note 74. Contra, Dobson v. Arkansas Oil & Gas Commission, 218 Ark. 160, 235 S.W.2d 33 (1950).

81 Kirk, Content of Royalty Owners' and Operators' Unitization Agreements, Third Annual Institute on Oil and Gas Law and Taxation 19, 29 (1952).

82 Cook, Rights and Remedies of the Lessor and Royalty Owner under A Unit Operation, Third Annual Institute on Oil and Gas Law and Taxation 101, 111 (1952).

agreement to the effect that all leases are amended by it.[83] Another usual clause provides that for all purposes except the determination of royalties, production on any part of the unit shall constitute production on the lease.[84] Similarly, it is common for the royalty owners' agreement to contain a clause which expresses the effect a surrender of all or part of one of the leases shall have on the unit.[85]

Thus modified, the individual leases begin to take on many of the aspects of a communitized lease. Therefore, it is necessary to insert an express provision that the cross-conveyancing doctrine shall not apply.[86]

B. THE BASIS OF PARTICIPATION

Of particular interest is the problem of determining the basis of participation in unit production. The parties must decide whether they wish to allocate the production on the acreage basis, on the basis of the relative value of the economically recoverable hydrocarbons in place under each tract,[87] or upon a combination of these factors.[88] The acreage basis may be inequitable for the reasons stated above. For those same reasons, any formula that relies in part upon the surface acreage basis may be inequitable to the extent that it so relies.

The value of the economically recoverable hydrocarbons in place basis is more likely to produce an equitable allocation, but the fairness of this basis is a direct function of the accuracy of the evaluations of the several tracts. The degree of accuracy is, in turn, a direct function of the time in the course of the reservoir's development that unitization is desired. This is true because the longer a reservoir has been worked, the more extensive and reliable is the information that is known about it. These considerations tend to

83 Sullivan, Handbook of Oil and Gas Law 395 (1955).

84 Ibid.

85 Voorhees, Techniques of Field-Wide Unitization, 24 Rocky Mt. L. Rev. 14, 23 (1951).

86 "A typical provision of this type is that, 'Nothing contained in this agreement shall be deemed to result in the transfer of all or any part of any party's legal title in any tract to any other party.'" Hoffman, Voluntary Pooling and Unitization 168, note 43, (1954).

87 For a discussion of tract valuation, see Roark, Matters of Mutual Concern to the Lawyer and Engineer in the Unitization Agreement, Seventh Annual Institute on Oil and Gas Law and Taxation 255, 289 et seq. (1956).

88 See Voorhees, op. cit. supra, note 85, at 24.

favor late unitization. However, it is also true that the earlier unitization occurs, the greater will be its advantages.[89] In combination these factors lead to the conclusion that the earlier unitization is accomplished the better it will be for the parties jointly, and the worse it will be for the parties severally.

One way to solve this dilemma is to unitize as early as it is determined that unitization is feasible, but to postpone the determination of participation until enough geological data to allow an accurate assessment of the value of the several tracts has been obtained. This method was used successfully in the development of Benton Field in Louisiana.[90] The Benton agreement provided that the participation would be determined on the basis of the economically recoverable hydrocarbons in place under each tract. Sufficient test wells were to be drilled to obtain the data necessary to an accurate evaluation, but no production was to be allowed from these wells until all tracts had been evaluated. After each tract was assayed, the parties were to compare the values and arrive at a participation formula by unanimous agreement. In the event that unanimous agreement was not obtained, the participation formula was to be determined by a specified engineering firm. The agreement also provided that one year after production had been obtained a second formula would be determined in the same manner as the first and that this second formula would be retroactive to the effective date of the agreement.[91] In this way, the parties were able to obtain the maximum benefit of unitization while insuring each individual party his fair share of the proceeds.

However, all of the parties may not agree that their fair share is limited to the relative value of the economically recoverable hydrocarbons in place under their tracts. For example, the owner of a tract overlying the compressed gas which, if allowed to expand toward other tracts would force the oil underlying those tracts to the surface, may feel that he should be compensated for refraining from releasing that gas into the atmosphere. Furthermore, unless he is restricted by statute, the failure to compensate him for his structural advantage may result in his wasting the reservoir energy,

[89] Murray, Engineering Aspects of Unit Operation, Third Institute on Oil and Gas Law and Taxation 1, 6-11 (1952). Voorhees, Techniques of Field-Wide Unitization, 24 Rocky Mt. L. Rev. 14,17 (1951).

[90] Sullivan, Handbook of Oil and Gas Law, 375 (1955).

[91] Kirk, Content of Royalty Owners' and Operators' Unitization Agreements, Third Annual Institute on Oil and Gas Law and Taxation 19, 54-58 (1952).

thereby preventing the recovery of oil from any of the tracts.[92] Therefore, in some situations the participation formula must account for factors in addition to the relative value of the oil and gas in place under each tract.

It may be noted that in the negotiation of the relative participation of each tract, the lessee and his lessor share the same general position vis-a-vis the other lessees and their lessors. However, this is not always true, for the interests of the lessee and his lessor may conflict in the determination of the dollar amount the lessor should receive from the unit. One such conflict arises if the lessor demands a share of the expenses that the lessee will save because he does not have to complete so many wells. Similar conflicts arise in the determination of the amount of gas on which royalties must be paid when some of the gas is used for unit purposes and some is not.[93]

Once these conflicts have been solved and the basis of participation has been determined, it is necessary to provide for the method of payment. Toward that end, the working interest agreement usually contains a provision for the accounting procedures that will be used in the unit.[94] It will also specify whether the production will be marketed by the unit operator or by the individual lessees.[95]

C. Determining Size

Similar to the problem of determining the participation of the several parties is the problem of defining the area of the unit.[96] This problem has two aspects. First, it is necessary to prescribe the initial size of the unit. Second, it is necessary to provide for the expansion and contraction of the unit.

Generally, there are three methods of defining the initial unit boundaries. The first method limits the original unit to property that is known to be productive and provides that additional tracts

[92] For a brief discussion of structural advantages, see Buckley, Petroleum Conservation 289 (1951). See also Roark, op. cit. supra, note 87.

[93] Merrill, Unitization Problems: The Position of the Lessor, 1 Okla. L. Rev. 119, 123 (1948).

[94] Sullivan, Handbook of Oil and Gas Law 392 (1955).

[95] This is one of the many facets of separate agreements which give rise to problems of taxation. See, Hill, Tax problems Arising Out of Unitization Agreements, Third Annual Institute on Oil and Gas Law and Taxation 427 (1952); and Brabson, Current Tax Problems in the Field of Unitization, Seventh Annual Institute on Oil and Gas Law and Taxation 627 (1956).

[96] When the acreage basis is used, the participation and size problems are completely intertwined.

may be brought into the unit as their capacity to produce is demonstrated. This method insures that only valuable tracts are included in the unit. However, the delay caused by the requirement of production deprives the parties of the advantages of early unitization. Furthermore, this method subjects the unit to the substantial risk that full scale operation may be delayed or seriously impaired by the failure to successfully negotiate the enlargement of the unit.[97]

The second method includes all of the property which may overlie the reservoir in the original unit, but allows only those tracts which are known to be productive to participate in the proceeds of unit production. This method assures the unit of the control of the reservoir. However, it requires each property owner to develop his property at his own risk and then turn his interest over to the unit in return for a proportional part of the whole. Because of that requirement, it is nearly impossible to negotiate such an agreement.[98]

The third method is similar to the second, except that the development of each of the tracts is carried on at the risk of the unit. When a tract is proved to be productive, its owners are allowed to participate in the unit on the basis of its relative value. This, of course, gives rise to the problems of valuation. Nevertheless, this type of agreement is easier to negotiate than the second type, and it assures an even greater control over the development of the reservoir.[99]

Regardless of the method used to define the initial unit boundaries, the unit agreement should contain specific provisions for the method of expanding or contracting them. In addition, when the acreage basis of production is used, and when the cross-conveyancing doctrine is not expressly negated by another clause in the agreement, the contracting clause must detail the effect that a release of part of the unit will have upon the retained portion of the unit.[100]

[97] Roark, Matters of Mutual Concern to the Lawyer and Engineer in the Unitization Agreement, Seventh Annual Institute on Oil and Gas Law and Taxation 275, 281 (1956). Voorhees, Techniques of Field-Wide Unitization, 24 Rocky Mt.L.Rev. 14, 19 (1951).

[98] Roark, op. cit. supra, note 97, at 282.

[99] Voorhees, op. cit. supra, note 97, at 19.

[100] Voorhees, op. cit. supra, note 85. Sullivan, Handbook of Oil and Gas Law 397 (1955).

D. Miscellaneous Provisions

The royalty owners' agreement may also contain an infinite number of other provisions. It may provide for the unit operator's right to use the surface of each of the tracts. It may provide specific authority for the unit operator to remove equipment.[101] Also, it may contain provisions providing for covenants of title, assignability, the effect of statutes, and so on.[102]

E. Effect

This type of agreement, like other contracts, sets the relationship of the parties according to its terms. It does away with the lessee's obligation to develop each lease individually. However, instead of eliminating the implied covenants, it shifts their operation from the individual lease to the unit as a whole.[103]

V. CONCLUSION

The community lease, the pooling clause, and the separate agreement all have the same general purpose, viz., to eliminate the waste caused by competitive tract-by-tract development of oil and gas reservoirs. The separate agreements are the most effective because they offer the opportunity for control of the entire reservoir, control that may only rarely be achieved through the use of community leases or pooling clauses. Furthermore, in Nebraska, the use of a community lease or a pooling clause which does not express the relationship of the lessors *inter se* necessarily means that the definition of that relationship will be realized only after extensive and hazardous litigation. On the other hand, if the expression of the lessors' relationship is undertaken in connection with the negotiation of the initial lease, the importance of that relationship may be over-emphasized and the perspective of the lease may be distorted. Moreover, if the necessary restrictions are written into the pooling clause, the lessee may not be able to effectively pool the lease. Therefore, it appears that the arresting of competitive tract-by-tract development can best be achieved through the use of an agreement that is separate from the oil and gas lease.

[101] Sullivan, op. cit. supra, note 100.

[102] Kirk, Content of Royalty Owners' and Operators' Unitization Agreements, Third Annual Institute on Oil and Gas Law and Taxation 19, 52 (1952).

[103] Young v. West Edmond Hunton Lime Unit, 275 P.2d 304 (Okla. 1954), *appeal dismissed,* 349 U.S. 909. See also, Merrill, Unitization Problems: The Position of the Lessor, 1 Okla. L. Rev. 119, 138 (1948).