

FORCE POOLING OF PARTIES FOR CURATIVE PURPOSES

FORCE POOLING THE TOP LESSEE

Oklahoma City Association of Petroleum Landmen
Educational Luncheon - March 4, 2019
Presented by Matthew J. Allen



TOPIC IN A NUTSHELL

- What are top leases, and what challenges do they pose?
- The Commission's jurisdiction over different kinds of interests/owners.
- "Curative" pooling – what is it?
- The ownership status of the top lessee in relation to a force pooling proceeding.
- Practical applications.
- **From the operator's perspective.**



BACKGROUND

The Oklahoma Corporation Commission

- Formed by the Oklahoma Constitution, BUT the constitution does not vest any authority or jurisdiction in the Commission for conservation matters.
- Instead, the Oklahoma Legislature determines conservation policy and scheme, then delegates authority to the Commission.
- In turn, Commission promulgates rules in accordance with Legislature's commands.
- This is why the Legislature has so much direct control over the Commission, and why even small changes to the conservation statutes can have dramatic effects.
- The limit of the statutory authority is the limit of the OCC!



OKLAHOMA STATUTES TIT. 52 SECTION 87.1

52 O.S. § 87.1 is the heart of Oklahoma's conservation statutes.

- Spacing
 - Authority to form drilling and spacing units and horizontal well units.
 - Procedure at Commission.
 - Maximum size of units.
 - Concurrent existence of units, including concurrent development.
- Pooling
 - Authority to force pool.
 - Procedure at Commission.
 - Concurrent development concepts.
 - "Protections" under § 87.1 (h).



CHALLENGING THE OCC'S JURISDICTION

- Three prongs of OCC jurisdiction:
 - Subject matter
 - Personal
 - Jurisdiction to enter order granting relief requested. (Statutory authority?)
- Today: analysis of third prong.
- Other example of third prong:
 - Wellbore v. Unit pooling!
 - *Amoco Production Co. v. Corporation Com'n of State of Okl.*, 1986 OK CIV APP 16, 751 P.2d 203.



CHALLENGING THE OCC'S JURISDICTION (CONT)

How does one “challenge” an order?

- Appear and challenge jurisdiction (safest).
- Jurisdiction may be raised at any time, so possibly direct appeal to Oklahoma Supreme Court.
 - Could be failure to exhaust administrative remedies.
 - If take benefit under pooling order, may waive right to challenge jurisdiction. *Tara Oil Co. v. Kennedy & Mitchell, Inc.*, 622 P.2d 1076



CHALLENGING THE OCC'S JURISDICTION (CONT)

What happens if an order
is successfully challenged?

In this context, the order will be at all times ineffective as to the relevant party.



FORCE POOLING UNDER § 87.1 – STATUTORY LANGUAGE

Where, however, such owners have not agreed to pool their interests and where one such separate owner has drilled or proposes to drill a well on the unit to the common source of supply, the Commission, to avoid the drilling of unnecessary wells, or to protect correlative rights, shall, upon a proper application therefor and a hearing thereon, require such owners to pool and develop their lands in the spacing unit as a unit. The applicant shall give all the owners whose addresses are known or could be known through the exercise of due diligence at least fifteen (15) days' notice by mail, return receipt requested. The applicant shall also give notice by one publication, at least fifteen (15) days prior to the hearing, in some newspaper of general circulation published in Oklahoma County, and by one publication, at least fifteen (15) days prior to the date of the hearing, in some newspaper published in the county, or in each county, if there be more than one, in which the lands embraced within the spacing unit are situated. The applicant shall file proof of publication and an affidavit of mailing with the Commission prior to the hearing. All orders requiring such pooling shall be made after notice and hearing, and shall be upon such terms and conditions as are just and reasonable and will afford to the owner of such tract in the unit the opportunity to recover or receive without unnecessary expense the owner's just and fair share of the oil and gas. The portion of the production allocated to the owner of each tract or interests included in a well spacing unit formed by a pooling order shall, when produced, be considered as if produced by such owner from the separately owned tract or interest by a well drilled thereon. Such pooling order of the Commission shall make definite provisions for the payment of cost of the development and operation, which shall be limited to the actual expenditures required for such purpose not in excess of what are reasonable, including a reasonable charge for supervision. In the event of any dispute relative to such costs, the Commission shall determine the proper costs after due notice to interested parties and a hearing thereon. The operator of such unit, in addition to any other right provided by the pooling order or orders of the Commission, shall have a lien on the mineral leasehold estate or rights owned by the other owners therein and upon their shares of the production from such unit to the extent that costs incurred in the development and operation upon the unit are a charge against such interest by order of the Commission or by operation of law. Such liens shall be separable as to each separate owner within such unit, and shall remain liens until the owner or owners drilling or operating the well have been paid the amount due under the terms of the pooling order. The Commission is specifically authorized to provide that the owner or owners drilling, or paying for the drilling, or for the operation of a well for the benefit of all shall be entitled to production from such well which would be received by the owner or owners for whose benefit the well was drilled or operated, after payment of royalty, until the owner or owners drilling or operating the well have been paid the amount due under the terms of the pooling order or order settling such dispute. No part of the production or proceeds accruing to any owner of a separate interest in such unit shall be applied toward payment of any cost properly chargeable to any other interest in the unit.



“OWNER”

Where, however, such owners have not agreed to pool their interests and where one such separate owner has drilled or proposes to drill a well on the unit to the common source of supply, the Commission, to avoid the drilling of unnecessary wells, or to protect correlative rights, shall, upon a proper application therefor and a hearing thereon, require such owners to pool and develop their lands in the spacing unit as a unit. The applicant shall give all the owners whose addresses are known or could be known through the exercise of due diligence at least fifteen (15) days' notice by mail, return receipt requested. The applicant shall also give notice by one publication, at least fifteen (15) days prior to the hearing, in some newspaper of general circulation published in Oklahoma County, and by one publication, at least fifteen (15) days prior to the date of the hearing, in some newspaper published in the county, or in each county, if there be more than one, in which the lands embraced within the spacing unit are situated. The applicant shall file proof of publication and an affidavit of mailing with the Commission prior to the hearing. All orders requiring such pooling shall be made after notice and hearing, and shall be upon such terms and conditions as are just and reasonable and will afford to the owner of such tract in the unit the opportunity to recover or receive without unnecessary expense the owner's just and fair share of the oil and gas. The portion of the production allocated to the owner of each tract or interests included in a well spacing unit formed by a pooling order shall, when produced, be considered as if produced by such owner from the separately owned tract or interest by a well drilled thereon. Such pooling order of the Commission shall make definite provisions for the payment of cost of the development and operation, which shall be limited to the actual expenditures required for such purpose not in excess of what are reasonable, including a reasonable charge for supervision. In the event of any dispute relative to such costs, the Commission shall determine the proper costs after due notice to interested parties and a hearing thereon. The operator of such unit, in addition to any other right provided by the pooling order or orders of the Commission, shall have a lien on the mineral leasehold estate or rights owned by the other owners therein and upon their shares of the production from such unit to the extent that costs incurred in the development and operation upon the unit are a charge against such interest by order of the Commission or by operation of law. Such liens shall be separable as to each separate owner within such unit, and shall remain liens until the owner or owners drilling or operating the well have been paid the amount due under the terms of the pooling order. The Commission is specifically authorized to provide that the owner or owners drilling, or paying for the drilling, or for the operation of a well for the benefit of all shall be entitled to production from such well which would be received by the owner or owners for whose benefit the well was drilled or operated, after payment of royalty, until the owner or owners drilling or operating the well have been paid the amount due under the terms of the pooling order or order settling such dispute. No part of the production or proceeds accruing to any owner of a separate interest in such unit shall be applied toward payment of any cost properly chargeable to any other interest in the unit.



“OWNER” (CONT)

The statute gives the OCC jurisdiction and authority to force pool “owners”.

(Who is an “owner”?)



“OWNER” – A TERM OF ART

§ 86.1 (4) provides a definition:

4. "Owner" means a person who has the right to drill into and to produce from any common source of supply and to appropriate the production, either for that person or for that person and others;



WHAT IS THE “RIGHT TO DRILL”?

The phrases “right to drill” or “drilling rights” are commonly understood to mean “working interest,” which is the operating interest under an oil and gas lease giving the party the right to explore for hydrocarbons and reduce them to possession.

H.R. Williams & C.J. Meyers, MANUAL OF OIL AND GAS TERMS (15th ed. 2012).



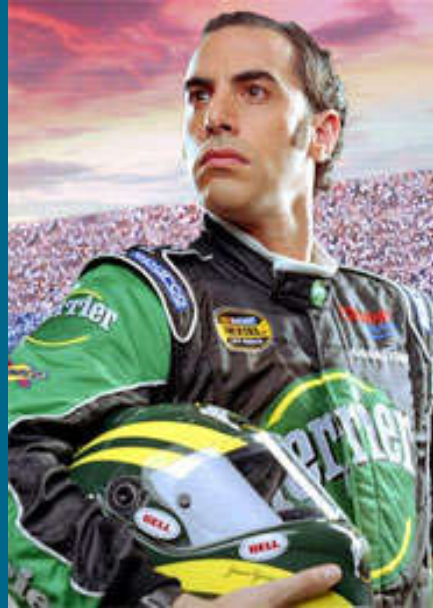
FANCY LEGAL TERMS

The “drilling right” or “working interest” is aptly characterized as a “profit à prendre.”

- French term meaning “right of taking.”
- Right to enter onto land of another and take some profit of the soil, or the soil itself.
- Examples:
 - Graze stock
 - Quarries
 - Orchard
 - Drilling rights



WHAT DID THE FRENCH EVER GIVE AMERICA?



- Democracy
- Existentialism
- Profit à Prendre

CW

WHAT GETS POOLED: THE OWNER OR THE INTEREST?

What does the pooling order impact?

- OCC Jurisdiction in a pooling is quasi in rem.
- Jurisdiction established when a party is named as a respondent and notice is served.
- But the effect of the order attaches to the property.
- *Harding & Shelton, Inc. v. Sundown Energy, Inc.*, 130 P.3d 776 (Okla. Ct. Civ. App. 2006).
 - Pooling order stayed effective as to interests, even though lessee was joined to the pooling, OGL terminated/released, drilling rights reverted to the MO, then leased again to unrelated 3P not covered by pooling order.
- There is still debate over this point. (Timing!)



“OWNER” IN CASE LAW: THE *O’NEILL* CASE.

O’Neill v. American Quasar Petroleum Co.

- 617 P.2d 181, 1980 OK 2.
- American Quasar filed pooling application, joining convertible overriding working interest owners.
- (The interest was an ORRI that could convert to working interest upon well payout.)
- Oklahoma Supreme Court analyzed the statutory provisions highlighted above.
- Court found that those owners had no assertible right in the oil and gas leasehold.
- Those parties could not be “owners” under § 86.1.



“OWNER” IN CASE LAW: THE *O’NEILL* CASE. (CONT)

Given that the respondents were not “owners” under the statute, the court found:

“From the preceding discussion we conclude the Corporation Commission is not clothed with authority by virtue of 52 O.S. 1971 § 87.1 (d) to enter an order such as that before us requiring the owner of an overriding royalty interest within a unit to elect between participation or acceptance of an alternative which disturbs the terms of the grant of the override.”



“OWNER” IN CASE LAW: THE *O’NEILL* CASE. (CONT)

In other words, the Commission did not have the authority or jurisdiction to enter the order covering those parties.

A FAILURE OF JURISDICTION.



WHAT TYPE OF OWNER/INTEREST CAN THE OCC POOL?

- A party who has an assertible ownership in drilling rights/leasehold.
- The *O'Neill* standard has been cited a number of times.
 - *BP Am. Prod. Co. v. Lo Yare, L.P.*, No. 104,680, 2008 WL 9876064, at 3 (Okla. Civ. App. July 11, 2008).
 - *Alliance Oil & Gas Co. v. Chesapeake Expl. Ltd. P'ship*, No. CIV-04-1779-W, 2006 WL 8436211, at 5 (W.D. Okla. Jan. 18, 2006).
 - *Grace Petroleum Corp. v. Corporation Comm'n of State of Okla.*, 1992 OK CIV APP 143, 841 P.2d 1172 at 1174.
- Well-settled point of law.



WHAT IS A TOP LEASE?

- A top lease is a “lease granted by a [mineral owner] during the existence of a recorded mineral lease which is to become effective if and when the existing lease expires or is terminated.” 8 Williams & Meyers, Oil and Gas Law, 1115 (2004).
- “A top lease is where the lease taken is subject to a pre-existing lease that has not expired when the second lease was taken.”
Voiles v. Santa Fe Minerals, Inc., 1996 OK 13.



WHAT IS A TOP LEASE? (CONT)

Prior to vesting, what does the top lessee hold or own?

- Depends on the language of the top lease.

Prior to adjudication, top lessee does not clearly hold or own drilling rights. (Maybe. Maybe not.)



POOLING A PARTY AS A “CURATIVE” MATTER

- “Curative” appears once in the Commission’s rules of practice.
 - OAC 165:5-15-3 – Rule covering respondents list appended to a pooling order.
- There is no definition of “curative” in the Commission’s rules.



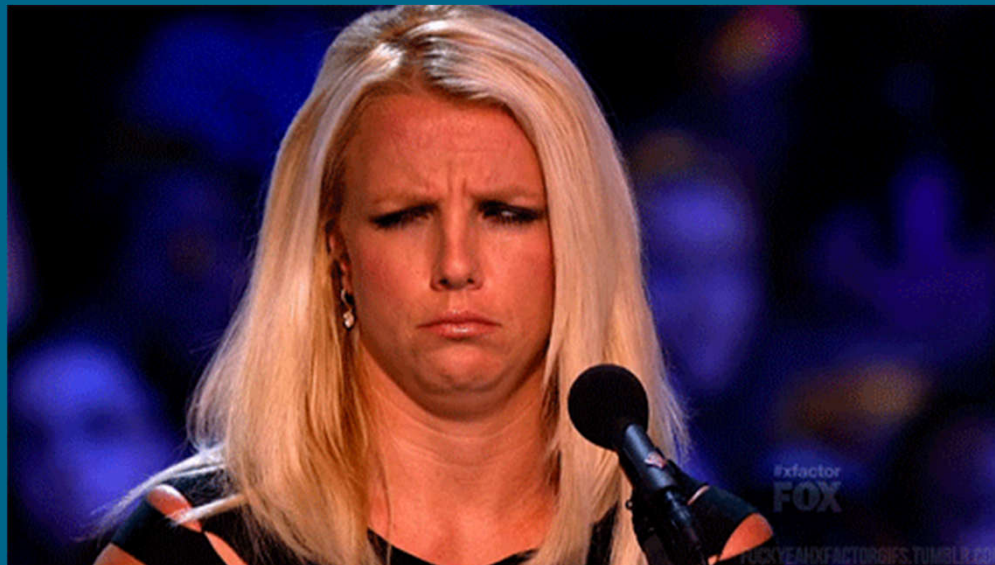
THEN WHAT IS A “CURATIVE” PARTY?

A party might be named for curative purposes when title to the drilling rights is unclear for a variety of reasons, or when a party is asserting ownership of the drilling rights.



CURATIVE V. *O'NEILL*

How do we square *O'Neill* – which demands the pooling respondent be the current owner of the right to drill - with pooling a curative party who does not have clear, vested title?



STEINKUEHLER V. HAWKINS OIL AND GAS, INC.

728 P.2d 520, 524; 1986 OK CIV APP 9,
cert. denied Nov. 12, 1986.

- Operator commenced operations on well during primary term of OGL.
- Operator encountered significant issues, had to P&A the borehole.
- Skidded the rig and commenced operations on replacement/substitute well.
- Commenced operations on second borehole after primary term ended.



STEINKUEHLER V. HAWKINS OIL AND GAS, INC. (CONT)

- Lessor threatened lease cancellation suit, so operator filed “curative” pooling at Commission.



- Obtained pooling order covering lessor.
- Lessor made election not to participate. (No cash and 1/4th)



STEINKUEHLER V. HAWKINS OIL AND GAS, INC. (CONT)

- Lessor sued in district court, challenging whether the lease had terminated.
- Alleged that operator's actions in plugging the well and filing curative pooling showed intent to abandon the OGL and separation between the operations.
- Trial court found that the P&A and the filing of the curative pooling indicated operator's belief the OGL had terminated.



STEINKUEHLER V. HAWKINS OIL AND GAS, INC. (CONT)

- Appellate court overturned the trial court, finding the OGL to be in effect.
- As to the curative pooling, the appellate court found:
 - The curative pooling was **not** indicative of operator's belief regarding the status of the well(s).



STEINKUEHLER V. HAWKINS OIL AND GAS, INC. (CONT)

Instead, found that the curative pooling was an:

“obvious safeguard procedure to protect [operator’s] interest in the well in the event the leases were cancelled.”



STEINKUEHLER V. HAWKINS OIL AND GAS, INC. (CONT)

Also, the court noted that the curative pooling might indicate a lack of confidence in legal position, but that the filing:

“could not be indicative of Hawkins’ earlier intent when it skidded the rig a short distance and continued drilling through a new bore hole.”



STEINKUEHLER V. HAWKINS OIL AND GAS, INC. (CONT)

In sum:

- **The OGL was found to be in effect.**
- **Lessor owned only a RI interest.**
- **Operator force pooled the lessor as a curative matter.**



STEINKUEHLER V. HAWKINS OIL AND GAS, INC. (CONT)

- **Did the Commission force pool a non-owner??**
 - It would appear so!
- **Did lessor challenge OCC jurisdiction?**
 - Who knows – probably not.
- **Was the order effective?**
 - Who knows – probably not?

But the operator had the order and an election to rely upon.



STEINKUEHLER V. HAWKINS OIL AND GAS, INC. (CONT)

What do we learn here?

- Curative pooling has been recognized by appellate courts as “an obvious safeguard”. (Legitimizing in a way?)
- The mere filing of a curative pooling does not evince an operator’s intent to abandon OGLs.
- The filing of a curative pooling is not a legal admission that the underlying OGL has failed.



HARDING & SHELTON, INC. v. PITCO

- 123 P.3d 56, 2005 OK CIV APP 88.
- Deep dive into the facts in submitted paper.
- Running out of time, so hitting the highlights.



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HARDING & SHELTON, INC. v. PITCO (CONT)

- Base Lessee v. Top Lessee and Operator.
- Base Lessee defended base leases; Top Lessee asserted base leases had terminated.
- Pooling filed by the Top Lessee.
 - (Top Lessee was not clearly in present, vested title to the drilling rights!)
- Initial well was deepening and recompletion project.
- Base Lessee appeared at OCC; opted to participate.



HARDING & SHELTON, INC. v. PITCO (CONT)

- Project went terribly.



- All parties switched legal positions.



HARDING & SHELTON, INC. v. PITCO (CONT)

- The base leases were adjudicated as terminated.
- Yet, the court ruled that Base Lessee could be held subject to pooling order based on a “personal jurisdiction” concept.
- Also discussed, but did not seem to rely upon, concept of judicial/equitable estoppel.
- Odd outcome.



HARDING & SHELTON, INC. v. PITCO (CONT)

Judicial estoppel:

This doctrine provides a party who knowingly assumed a particular position dealing with matters of fact is estopped from assuming an inconsistent position to the prejudice of the adverse party. This rule ordinarily applies to inconsistent positions assumed in the course of the same judicial proceeding or in subsequent proceedings where the parties and questions are identical. *Capshaw v. Gulf Ins. Co.*, 2005 OK 5, n. 28, 107 P.3d 595, 602.



HARDING & SHELTON, INC. v. PITCO (CONT)

Equitable estoppel:

At its most basic, “[e]quitable estoppel is employed to prevent one party from taking a legal position inconsistent with an earlier action that places the other party at a disadvantage.” *Merritt*, 2003 OK 68 at ¶ 15, 73 P.3d at 883. It “holds a person to a representation made, or a position assumed, where otherwise inequitable consequences would result to another, who has in good faith, relied upon that representation or position.” *Id.* (citing *Oxley v. Gen. Atl. Res., Inc.*, 1997 OK 46, ¶ 20, 936 P.2d 943, 947).



THE CASE LAW

- *O'Neill* seems strict.
- *Steinkuehler* recognized curative pooling, tacitly allowing the pooling of a lessor.
- *PITCO* explicitly affirmed the pooling of a Base Lessee w/terminated OGLs, a non-owner.



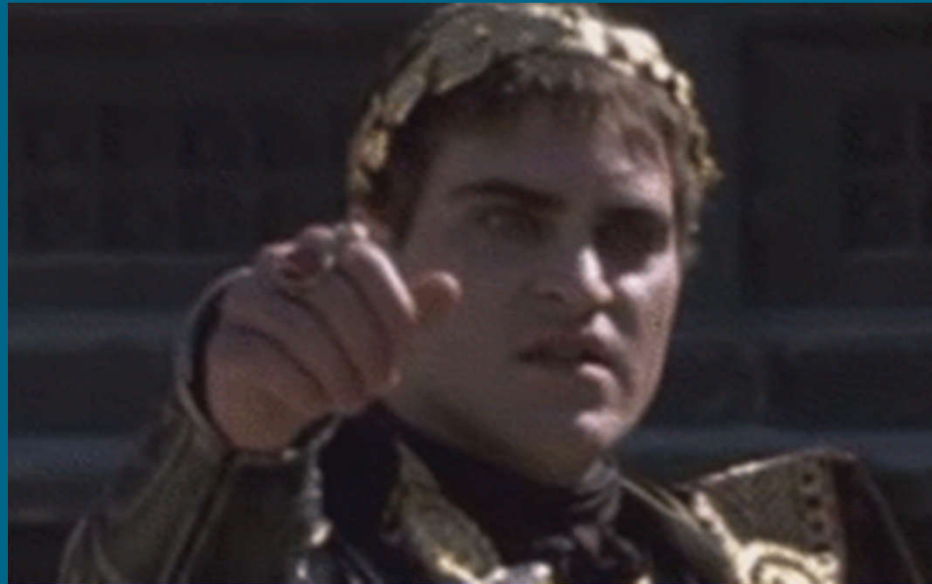
THE CASE LAW (CONT)

- It's not that case law is confused, exactly.
- It's that it is disconnected.
- By design, appellate cases focus on limited issues. in each case.
- So busy focusing on one limited point of law, the overall body of theory gets muddled.



CW

COOL SLIDE SHOW, BRO – CAN I POOL A TOP LESSEE?



COOL SLIDE SHOW, BRO – CAN I POOL A TOP LESSEE? (CONT)

- Pooling a top lessee is likely to be fact-driven:
 - If the top lessee has filed a lease cancellation suit, then a curative pooling is appropriate.
 - Plus, the benefit of judicial estoppel!
 - If the top lessee has asserted ownership and/or threatened a lease cancellation suit, then a curative pooling is appropriate.
 - Expressly recognized in *Steinkuehler*.
 - Equitable estoppel.



COOL SLIDE SHOW, BRO – CAN I POOL A TOP LESSEE? (CONT)

- If the top lessee has merely recorded a lease, and the lease form is a top lease form, a curative pooling might not be effective.
- If the top lessee has merely recorded a lease, and the lease form is a base lease form, a curative pooling might not be effective.



COOL SLIDE SHOW, BRO – CAN I POOL A TOP LESSEE? (CONT)

Some important caveats:

- Even if a party would not normally be subject to a pooling, the party might become subject to the pooling if the party takes a benefit thereunder. *Grand River Dam Authority v. Eaton*, 1990 OK 133, 803 P.2d 705, 708, discussing *Tara Oil Co. v. Kennedy & Mitchell, Inc.*, 622 P.2d 1076
- So if a party is pooled for curative reasons, and the order might would fail, could be made effective if the checks are cashed.



COOL SLIDE SHOW, BRO – CAN I POOL A TOP LESSEE? (CONT)

Some important caveats:

- The *O’Neill* problem is jurisdictional. That would not be evident on the face of the proceeding.
- Jurisdiction may be raised at any time.
- If a non-owner is pooled, and is found later to be an inappropriate party to be pooled under *O’Neill*, then the pooling order might not be good and may never have been as to that party.
 - Did you pay that party cash bonus? Escrow?



Some important caveats:

- Make abundantly clear that the pooling is for curative purposes.
 - May inadvertently admit leases are not good!
 - Recommendation: do not commingle respondents.
- Plan for escrow pending outcome of title dispute.



Some important caveats:

- Even if the pooling fails, what choice did you have?
 - EITHER your base leases are determined to be in effect – the desired outcome – and the pooling is ineffective.
 - OR your base leases are terminated at some point in the past, and your curative pooling order is likely effective.
 - Or maybe you are challenged at OCC, lose and at least know where you stand.



Benefits:

- Force the top lessee to appear and assert a position at OCC.
 - Judicial/Equitable estoppel.
 - Force an outcome to eliminate uncertainty.
 - A bad outcome early may be preferable to lingering uncertainty. (Can make decisions!)



COOL SLIDE SHOW, BRO – CAN I POOL A TOP LESSEE? (CONT)

Benefits:

- Fair market value
 - In a pooling, the Commission will determine FMV of drilling rights.
 - FMV is based on consummated OGLs in single-section deals.
 - The FMV may be significantly less than what the top lessee offers in settlement.
 - If obtain the pooling order, may have placed a ceiling on financial exposure, thereby assisting in settlement negotiations.



QUESTIONS/COMMENTS?

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