

POOLING AND LEASING OF OIL & GAS INTERESTS*

Introduction.

Colorado law allows the ownership of oil & gas rights lying underground to be separated from ownership of the surface. The extraction and development of oil & gas resources is a State-regulated activity. This memorandum focuses on two aspects of oil & gas resource development: leasing and pooling.

Oil & Gas Leasing.

Oil & gas owners in Colorado can elect to sell or lease their oil & gas rights to anyone at any time, so long as the rights are not under an existing oil and gas lease. The most common form of oil & gas transactions between owners and industry operators is leasing.

An Oil and Gas Lease Agreement is a contract between the Oil & Gas Owner (Lessor) and an Oil and Gas Operator (Lessee). The Lease Agreement outlines the various rights and obligations of the Lessor and Lessee. Generally speaking, a Lease Agreement allows the Owner/Lessor to keep the oil & gas rights, while assigning to the Operator/Lessee the costs and effort of exploration and production. A Lease Agreement *may* include permission for the operator to use the surface of the land (“Surface Use Agreement”) for exploration and production operations. In some situations the parties negotiate a “No Surface Occupancy” clause which prevents the Operator/Lessee from using the Owner/Lessor’s surface for oil & gas activity. In that case, the Operator/Lessee must find another location for surface activity.

The Owner/Lessor will generally receive an up-front non-refundable “signing bonus” payment. If oil & gas production is later established, the Owner/Lessor receives royalty payments based on a percentage of the production value. The Lease Agreement gives the Operator/Lessee the right to explore for oil & gas for a defined period of time (Primary Term). If exploration activity does not take place within the primary term, the lease expires. No royalties are paid, and the Owner/Lessor keeps the non-refundable bonus payment. If exploration activity or production occurs during the primary term, the Lease may be extended, and royalty payments continue.

Pooling.

Pooling of oil & gas interests is the way multiple oil & gas owners can be collected together into a common source of supply for purposes of exploration, production and revenue allocation. Pooled resources are broken into “spacing units” through a regulatory process under the authority of the Colorado Oil and Gas Conservation Commission (COGCC). The primary purposes of pooling and spacing units is to avoid waste of the resources and assure efficient accounting for all oil & gas owners affected by extraction of the resources.

* This Memorandum was authored in May, 2019, by Kenneth Lind of Lind, Ottenhoff & Root, LLC. This Memorandum contains general information, and should not be deemed to be or relied upon as legal advice. Readers are urged to consult independent legal counsel as to all matters affecting their interests, whether covered herein or not.

Prior to receiving a pooling order from the COGCC, an Operator is required to make fair and reasonable offers to all oil & gas owners, and provide oil & gas owners the opportunity to voluntarily participate in the activity proposed by the Operator. This process provides Operators certainty in the planning and execution of their development plans in a way that is fair and equitable to all leased and unleased oil & gas owners.

Operators will typically ask the COGCC to create a spacing unit and pool the underlying interests within the spacing unit to account for all consenting (leased) and non-consenting interests. Colorado law requires the consent of Owners, through either leasing or other participation, of 45 percent of the relevant mineral interests in the spacing unit to join a pooling application. The operator is responsible for gathering leases and other participants to get to this minimum. Once the minimum is met, the interests of non-consenting oil & gas owners within the spacing unit are subject to the COGCC pooling order as provided by the statutes. This statutory pooling process is sometimes referred to as “force-pooling” - - the interests of non-consenting oil & gas owners are compelled into production, with statutory royalty payments being substituted for the terms of a negotiated lease or other form of consenting participation in the Operator’s activity.

Effects of Statutory Pooling.

Oil & gas owners who are statutorily pooled retain full ownership of their oil & gas interests. Under the statutes, these non-consenting owners receive a statutorily-fixed royalty from the producing wells. Statutory pooling does not provide for “signing bonus” payments. Statutory pooling does not compel non-consenting mineral owners to allow surface use on their lands.

Questions.

Oil & gas owners are encouraged to consult with competent independent legal counsel on all matters involving leasing, pooling and spacing.