



## 10th Circuit Decision Offers “Clause” For Alarm (Pooling/Unitization, That Is)

By: [Fred MacDonald](#) and [Tony Hunter](#)

On October 27, 2009, the United States Court of Appeals for the Tenth Circuit handed down its decision in *Trans-Western Petroleum, Inc. v. Wolverine Gas and Oil Corp., et al.*, 584 F.3d 988, C.A.10 (Utah) which serves as a stark reminder to lawyers and landmen to carefully review the terms and conditions of fee pooling/unitization clauses before having the lessee unilaterally exercise the rights granted therein. The case can be read in its entirety at <http://www.ca10.uscourts.gov/opinions/08/08-4120.pdf>.

The case involved a dispute between a lessee/unit operator (Wolverine) and a top lessee (Trans-Western) of a fee tract surrounded by federal acreage. Wolverine purported to unilaterally commit, i.e. without separately obtaining the lessor’s joinder, its lease to a federal exploratory unit based on unitization language found in the lease, and believed that the lease was preserved past its primary term due to unit operations and production even though none of the leased lands had yet been included in a participating area. Despite Wolverine’s actions, the lessor granted a top lease to Trans-Western. Trans-Western argued that the unitization language in Wolverine’s lease did not grant Wolverine the authority to unilaterally commit the lease to a unit with the participating area allocation scheme found in federal exploratory units, and therefore Wolverine’s unitization was improper and its lease expired at the end of its primary term.

The unitization clause of Wolverine’s lease initially reads like those contained in many Rocky Mountain fee leases:

In connection with operations for the production of oil and gas or either of them, Lessee may at any time or times pool or unitize this lease...with other lands and leases in the same area

or field so as to constitute a unit or units whenever, in Lessee's judgment, necessary or advisable to comply with a law, rule, order or regulation of a governmental authority having jurisdiction, to reduce or prevent economic waste, to protect correlative rights or to promote, encourage or accomplish the conservation of natural resources, by filing of record an instrument so declaring....

The clause, however, continues with the following "subject to" proviso:

Units formed to accomplish a cycling, pressure maintenance, repressuring or secondary recovery program, or any other cooperative or unit plan of development or operation involving multiple wells must be approved by the governmental authority having jurisdiction and shall allocate to the portion of this lease included in any such unit a fractional part of production from any part of such unit on one of the following bases: (i) the ratio between the quantity of recoverable production allocable to the portion of this lease included in such unit and the total of all recoverable production allocable to such unit; or (ii) such other basis as may be approved by the governmental authority having jurisdiction thereof. (emphasis added).

Because of the surrounding federal acreage, the unitization logically required establishment under the federal exploratory scheme, which by regulation mandates production allocation on a participating area basis (*see* 43 C.F.R. §3186.1(1993)). The Unit Agreement was duly recorded, the Unit had a multiple well "public interest" requirement, and Unit paying quantities production was established in the Unit area before the end of the Wolverine lease's primary term; albeit, none of the leased lands had been included within the resulting participating area. In the litigation, the parties stipulated that the Bureau of Land Management was the governmental agency having jurisdiction over the federal unit.

Trans-Western argued that Wolverine's lease clearly and unambiguously required, as a precondition to allowing the lessee to unilaterally unitize, the unitization plan to allocate some fractional part of production to the lease from any part of such unit. If the government-mandated allocation scheme failed to do so, then Wolverine exceeded its contractual authority to unitize the lease and, in the absence of proper unitization, the lease expired at the end of its primary term. Wolverine countered that, because unitization logically could occur only under the federal scheme and because that scheme

by regulation mandates production allocation on a participating area basis, the scheme constituted the allowed "other basis" for allocation under subsection (ii) even if it might result in zero allocation to the disputed leasehold. That "zero" fractional allocation method would still preserve the lease past its primary term, because it was the only possible "other basis" that would be (and ultimately was) approved by the BLM. The Court, however, agreed with Trans-Western.

The lesson to be learned? Pooling and unitization clauses must always be carefully reviewed. If there is any doubt as to the scope of the right of the lessee to unilaterally pool/unitize the lease, the joinder of the lessor should always be solicited.



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