Colorado Landowner's Guide

What is Forced Pooling?

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To drill a well, the oil and gas operator would like to acquire, through purchase, lease, or agreement, the right to extract the oil and gas accessed by the well. But what if there are mineral owners in that area that do not want to allow drilling? Then the operator has the ability to apply to the Colorado Oil and Gas Conservation Commission (COGCC) to "force pool" the reluctant mineral owners – thereby allowing the mineral development to go forward. The forced pooling laws are found in **C.R.S. §34-60-116** and **COGCC Rule 530**.

Forced pooling is often threatened by landmen to persuade reluctant mineral owners to lease their minerals. **But the threat of forced pooling should not be used to pressure a mineral owner to hastily sign a lease.** Unfortunately, the right to force pool mineral owners is being abused by some companies in Colorado. It is estimated that hundreds of mineral owners are forced pooled every year in Colorado. Notices of forced pooling are now routinely sent out with a first offer to lease.

In negotiating with a landman, it is helpful for a mineral owner to understand the process of forced pooling. Before an operator can pool an area, the area must be included into a **drilling unit**. This is done through an application with the COGCC. The COGCC defines a "drilling unit" as the largest amount of acreage that can be efficiently and economically drained by a single well. C.R.S. §34-60-116(2). Thus, a landowner who only owns a percentage of the minerals under his land may be made part of a drilling unit, regardless of the size of the unit. Likewise, if a "common source of supply" (i.e. a large reservoir of oil) underlies several parcels of land, all the mineral rights underlying those parcels may become part of a single drilling unit.

To create a **drilling unit**, the COGCC defines the boundaries of the "common source of supply" and determines the approximate location of the well in that drilling unit that will efficiently drain the resource. All of the unleased mineral owners within the proposed drilling unit are given notice (Rule 507(b)) and may require a hearing on the drilling unit by submitting a formal protest to the COGCC. (Rule 509). In the past, these hearings were limited to a discussion about the underlying geology of the area. Since Senate Bill 19-181, a mineral owner now can object to the size or shape of the drilling unit as well as the surface impacts that accompany the drilling. Since Senate Bill 19-181, the COGCC is tying a drilling unit with the corresponding Form 2As (location permits).

A **pooling application** may be requested after, or concurrently with, a drilling unit application. However, due to Senate Bill 19-181, the pooling applicant must have leased or otherwise control 45% of the unit. A pooling application notice must be sent to all unleased mineral owners within a unit. Unleased mineral owners will also be sent an **election letter** – typically through certified mail. Unleased mineral owners will be given three options: They can choose to lease their minerals, consent to voluntarily pool his mineral interest with the others and participate (financially) in the drilling operation, or be a "non-consenting" owner and be "forced pooled." The unleased mineral owners may be considered "non-consenting" if they have not responded to an election letter and the reasonable offer to lease ***within 60 days.***

To "**force pool**" a non-consenting mineral owner, the industry must have made the non-consenting mineral owner a ***reasonable offer to lease.*** If the forced pooling application is formally contested by the mineral owner (Rule 509), the COGCC will hold a hearing to determine if the offer to lease was reasonable. Reasonableness of the offer is determined by comparing the terms offered in the lease to terms accepted by adjacent mineral owners. Before the hearing, the non-consenting mineral owner should request copies of the operator's lease agreements and bonus payments paid to all other mineral owners in the unit. At the hearing, the non-consenting mineral owner may only present information as to why the lease terms offered were not reasonable (Rule 530(c)) or challenge the operator's compliance with the rules or statutes (such as notice of meeting the required minimum 45% threshold).

A lease offer may also be found unreasonable if it gives insufficient time to respond or contains unreasonable terms. For example, a low bonus payment (compared to other bonus payments paid in the area) could make a lease unreasonable. A lease that lasts more than five years could also be unreasonable.

If the COGCC issues a force pooling order, there are five consequences for the non-consenting owner; 1) oil and gas operations in that drilling unit are allowed to proceed, 2) the mineral owner will ***not*** get a signing bonus, 3) if drilling occurs, the mineral owner will receive a 16% mineral royalty payment for an oil well or 13% for a gas well, 4) the other mineral revenue is used to pay-off the costs of the well (plus penalties), and 5) the operator will ***not*** be able to locate the well or facilities on a parcel that is forced pooled.

The non-consenting mineral owners' working interest in the well is their proportionate share of mineral rights in the drilling unit. For example, if two mineral owners (a married couple) had ten (10) acres of mineral rights in a forty-(40) acre drilling unit, their working interest in the well would be 25%. To obtain a working ownership interest, they would be required to pay 25% of the costs but then would receive 25% of the income.

Because the non-consenting owners have not paid their (25%) share of the costs, they will not receive their working interest income until those costs are paid. Instead, the non-consenting owners will only get a 13-16% mineral interest payment from that working interest. The other income is withheld by the operator until the amount collected equals the non-consenting mineral owners' proportionate costs of operating the well and off-site equipment, and **double** the proportionate costs of drilling and completing the well. Once the costs are paid, then the mineral owners get their full proportionate share of the well (in our example, the full 25% working interest share).

Here is an (oversimplified) example of how it works using *completely* fictional numbers:

- If the force-pooled mineral owners own 25% of the minerals in the drilling unit, then those owners would get 16% royalty (for an oil well) of their 25% share of production proceeds (.16 x .25 = 4%)
- The other 84% of the force-pooled mineral owner's proportionate income goes to pay the mineral owner's proportionate costs of annual operation and off-site equipment (25%), and **double** the proportionate costs of drilling the well (50%).
- For the sake of convenience, let's say the cost of drilling a well is three-million ($3,000,000), off-site equipment is $100,000, and the cost of annual operations are $100,000/year.
- The costs that must be recouped by the operator before the mineral owners become a part-owner of the well are:
    - 50% of $3,000,000 drilling costs = $1,500,000
    - 25% of $100,000 of off-site equipment = $25,000
    - 25% of $100,000/year in operating costs= $25,000/year
- If the well generates an average of one million ($1,000,000) in revenue a year, the working interest in our example would be 25% of one million= $250,000 (minus costs).
- The royalty payment the mineral owner receives is 16% of $250,000 = $40,000/year.
- The other 84% of the mineral owner's proportionate income would go to pay the costs of the well listed above. 84% of $250,000 = $210,000

In this scenario, it would take over **eight years** to pay the proportionate share of the costs that must be recouped before the non-consenting mineral owners get their 25% ownership share in the well. At that point, the well production will have substantially declined. However, many wells are productive for decades.

This scenario is, of course, based on completely fictional numbers. Recently, the costs of drilling wells in the Niobrara have been as high as $6 million. Yet, if the well is a real producer, like the *Jake* well in Weld County, it would pay-off in less than one year. Other wells never pay off.

In summary,

- Forced pooling is a real threat to large and small landowners or mineral owners.
- Forced-pooled mineral owners will not receive a bonus payment and will only receive 13-16% royalty until the income from the well pays double the costs of drilling the well.
- Mineral owners who receive an "election packet" and an offer to lease have only 60 days to respond or they will be considered "non-consenting" and may be subject to forced pooling.
- If threatened with forced pooling, legal representation may be necessary to protect your rights.