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Pooling Provisions in Oil and Gas Leases

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INTRODUCTION

Drilling an oil and gas well today is a complex operation. Before drilling a new well the operator[1] must determine the well's location, obtain the right to explore for oil and gas,[2] and as required by statute,[3] obtain a permit. This Comment investigates situations involving leases which have been combined or "pooled"[4] to create a new lease. In such situations confusion often results concerning division of the lease's production.[5]

An oil and gas lease does not convey title to the oil and gas beneath the earth, but gives the lessee a right to explore for, and

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[1] KY. REV. STAT. § 353.510(17) (Michie 1982) [hereinafter KRS] provides:

> 'Operator' means any owner of the right to develop, operate and produce oil and gas from a pool and to appropriate the oil and gas produced therefrom, either for himself or for himself and others; in the event that there is no oil and gas lease in existence with respect to the tract in question, the owner of the oil and gas rights therein shall be considered as 'operator' to the extent of seven-eights (7/8) of the oil and gas in that portion of the pool underlying the tract owned by such owner, and as 'royalty owner' as to one-eighth (1/8) interest in such oil and gas; and in the event the oil is owned separately from the gas, the owner of the right to develop, operate and produce the substance being produced or sought to be produced from the pool shall be considered as 'operator' to such pool.

See also H. WILLIAMS & C. MEYERS, MANUAL OF OIL AND GAS TERMS 595 (6th ed. 1984) [hereinafter WILLIAMS & MEYERS].

[2] *See infra* notes 4-6 and accompanying text. An operator may obtain the right to drill for oil and gas in one of three ways: purchase, lease or assignment.

[3] KRS § 353.570(1) (1983) provides:

> No person shall drill or deepen a well, or reopen a plugged well for the production of oil or gas or for the injection of water, gas or other fluid into any oil or gas producing formation (except seismograph test holes) after June 16, 1960, or drill or deepen a water supply well, and geological or structure test holes after June 16, 1966, until such person shall obtain a permit from the department [of mines and minerals as defined in KRS § 351.010].

[4] WILLIAMS & MEYERS, *supra* note 1.

[5] Rice Bros. Mineral Corp. v. Talbott, 717 S.W.2d 515 (Ky. Ct. App. 1986).

take title to the oil and gas produced.[6] Unlike solid minerals,[7] oil and gas are fugacious[8] in nature, resembling wild animals.[9] As fugacious minerals, oil and gas are not owned until severed and produced from the earth. The oil and gas lessee's interest, therefore, is a non-possessory interest in real property.[10]

A conveyance[11] is the transfer by either the lessee or lessor[12] of his interest, in whole or in part,[13] to a third party. Absent a restriction in the lease, the lessee under an oil and gas lease may convey any and all lease rights to a third party.[14]

A drilling permit is issued only when the well location is sufficienty far from other wells and property lines.[15] When the lease size is insufficient to meet the well spacing requirements,

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[6] Sellars v. Ohio Valley Trust Co., 248 S.W.2d 897, 900 (Ky. 1952); Trimble v. Kentucky River Coal Corp., 31 S.W.2d 367, 369 (Ky. 1930).

[7] 717 S.W.2d at 516 (stating that "[s]olid minerals in place are attached to the land itself, but title to, or interest in, those minerals may be severed from the land.").

[8] D. WEBSTER'S NEW INTERNATIONAL DICTIONARY (3rd ed. 1981) (defining fugacious as "2. Not fixed in a certain place: wandering").

[9] Hammonds v. Central Kentucky Natural Gas Co., 75 S.W.2d 204, 205 (Ky. 1934). *But see* Texas Am. Energy Corp. v. Citizens Fidelity Bank and Trust Co., 736 S.W.2d 25, 26 (Ky. 1987) (overruling *Hammonds*).

[10] Williams' Adm'r v. Union Bank and Trust Co., 143 S.W.2d 297, 300 (Ky. 1940); *see also* HEMINGWAY, THE LAW OF OIL AND GAS § 6.1, at 240 (1983).

[11] *See supra* note 6 and accompanying text.

[12] HEMINGWAY, *supra* note 10, § 9.8 at 483.

[13] *Id.*

[14] Rice Bros. Mineral Corp. v. Talbott, 717 S.W.2d 515, 517 (Ky. Ct. App. 1986); *cf.* Coleman v. Owens, 245 S.W.2d 341 (Ky. 1953).

[15] KRS § 353.610(1)-(2) (1983) provides:

> (1) Except as provided in KRS 353.500 to 353.720, no permits shall be issued for the drilling, deepening, or reopening of any shallow well for the production of oil, unless the proposed location of the well shall be at least three hundred thirty (330) feet from the nearest boundary of the premises upon which the well is to be drilled, deepened or reopened; and, the proposed location must be at least six hundred sixty (660) feet from the nearest oil producing well. This subsection shall not be construed to regulate the distance between wells which do not produce oil from the same pool.
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> (2) Except as provided in KRS 353.500 to 353.720, no permits shall be issued for the drilling, deepening, or reopening of any shallow well for the production of gas unless the proposed location of the well be at least five hundred (500) feet from the nearest boundary of the premises upon which such well is to be drilled, deepened or reopened; and, the proposed location must be at least one thousand (1000) feet from the nearest gas producing well. This subsection shall not be construed to regulate the distance between wells which do not produce gas from the same pool.

See also 805 KY. ADMIN REGS. 1:100 (1988).

pooling[16] becomes necessary. Pooling is the consolidation of the oil and gas rights to two or more small tracts into a tract large enough to meet the spacing requirements for obtaining a permit.[17] Operators using pooling for many reasons, the most important being conservation of oil and gas, assurance of obtaining a permit, and increasing flexibility in matching surface operations to geological structures.[18]

Pooling may be accomplished by voluntary agreement,[19] a community lease,[20] a pooling clause in the lease,[21] or by administrative order.[22] Voluntary pooling is accomplished by "written

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[16] *See generally* WILLIAMS & MEYERS, *supra* note 1, at 652 (stating that pooling is "[t]he bringing together of small tracts sufficient for the granting of a well permit under applicable spacing rules. . . .").

[17] *Id.*

[18] *Id.*

[19] D. SHORT & R. THOMAS, KENTUCKY MINERAL LAW § 31.02(A), at 127 (1986) [hereinafter SHORT], which provides:

> All of the . . . owners can voluntarily form a unit by executing an agreement. . . .
>
> Voluntary pooling agreements range from a very simple document which allocates the royalty and establishes a single producing entity, thereby eliminating concerns about internal drainage or the need to develop each lease separately, to the complex field-wide agreement discussed under 'voluntary unitization' (footnote omitted).

[20] *Id.* § 31.02(B), at 128, which provides: "A community lease commits several tracts of land having separate mineral owners to a single leasehold and, therefore, a common development. . . . It is a form of voluntary pooling, the terms and conditions of which are controlled by the lease itself."

[21] *Id.* § 31.02(C), at 128, which provides: "The pooling clause in a lease authorizes the lessee or the lessee's assignees to establish units without the consent or joinder of the lessors. This is done by executing an 'instrument identifying and describing the pooled acreage,' which is generally referred to as a pooling declaration." (footnote omitted).

[22] KRS § 353.630(1) (Supp. 1988) provides:

> Whenever any separate tract of land is so situated because of size or other condition that it does not contain a location at which a well for oil or gas may be drilled, deepened or reopened by reason of the spacing provisions of KRS 353.610, the department shall order, after notice and a hearing, the pooling of all oil and gas interests in the separate tract or in a portion thereof with all like interests in a contiguous tract or tracts, or portions thereof, as are necessary to afford the pooled tracts one (1) location for the drilling, deepening or reopening of a well for the production of oil or gas in compliance with the spacing requirements of KRS 353.500 to 353.720. The department shall require the development and operation of all pooled tracts as a single leasehold estate in accordance with regulations and rules promulgated under KRS 353.500 to 353.720.

consent of all owners of oil and gas interest"[23] in a pool.[24] Typical oil and gas lease forms, such as the *Producer's 88 Revised*,[25] contain pooling clauses which give the lessee power to pool the leased acreage with other tracts,[26] and to apportion[27] the landowner's royalties.[28] These royalties are apportioned pro-rata according to each landowner's contribution of acreage to the total pooled acreage[29] or unit.[30] Though the unit may be any

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[23] KRS § 353.620(1) (1983) provides:

> Notwithstanding KRS 353.610, if an application is submitted for a permit to drill, deepen or reopen a well closer to a boundary or to another well than prescribed in KRS 353.610 and the application is accompanied by the written consent of all owners of oil and gas interests in any premises which will be offset by the proposed well, the department shall issue a permit for the well.

[24] Smith v. Rogers, 702 S.W.2d 425, 427 (Ky. 1986); *see also* KRS § 353.620 (1983).

[25] SHORT, *supra* note 19, § 23.01, at 35, provides: "[T]he typical Producers 88 Revised form . . . includes a pooling clause, an entireties clause, a shut in gas well clause, and even a gas storage clause." (footnote omitted); *see also* Hinton, *Negotiating Oil and Gas Leases for the Lessee*, 1 NAT. RESOURCES ENV'T. 7 (Spring 1985).

[26] *See e.g.*, SHORT, *supra* note 19, form 23.01, at 10, which provides:

> Lessee is hereby given the right and power to pool or combine the acreage covered by this lease or any portion thereof with other land, lease or leases in the immediate vicinity thereof, when in lessee's judgment it is necessary or advisable to do so in order properly to develop and operate said premises in compliance with the spacing rules of any lawful authority, or when to do so would, in the judgment of the lessee, promote the conservation of the oil and gas in and under and that may be produced from said premises. In connection with the production of oil, such pooling maybe in a unit or units not exceeding 50 acres each. In connection with the production of gas such pooling may be in a unit or units not exceeding 320 acres each. Lessee shall execute in writing an instrument identifying and describing the pooled acreage. The entire acreage so pooled into a tract or unit shall be treated, for all purposes except the paying of royalties on production from the pooled unit, as if it were included in this lease. If production is found on the pooled acreage, it shall be treated as if production is had from this lease, whether the well or wells be located on the premises covered by this lease or not. In lieu of the royalties elsewhere herein specified, lessor shall receive on production from a unit so pooled only such portion of the royalty stipulated herein as the amount of his acreage placed in the unit or his royalty interest therein bears to the total acreage so pooled in the particular unit involved. Provided, lessee shall be under no obligation whatsoever, express or implied, to drill more than one well to each such unitized tract, regardless of when, where or by whom offset wells may be drilled.

[27] WILLIAMS & MEYERS, *supra* note 1, at 45. Apportionment is the division of royalties among the owners of interests in the land subject to the lease. The basis of division is each land interests' contribution to the total acreage. *Id.*

[28] *See infra* notes 33-34 and accompanying text.

[29] *See supra* note 27 and accompanying text.

[30] WILLIAMS & MEYERS, *supra* note 1, at 651.

shape,[31] the fugacious nature of oil and gas necessitates using a simple shape such as circle or a square.[32]

Drilling commences after executing all leases, conveyances, pooling agreements, and obtaining the permit. In the event a well produces, the operator divides the production into payments called royalties.[33] A landowner's royalty is his share of the oil and gas produced free from the expenses of production,[34] payable either in money or in kind.[35] An overriding royalty, the royalty paid to the lessee, is "a royalty interest carved out of the lessee's interest under an oil and gas lease."[36] It is "[a]n interest in oil and gas produced at the surface, free of the expense of production, and in addition to the usual landowner's royalty reserved to the lessor in an oil and gas lease."[37]

Generally, landowners who have leased the mineral rights retain a landowner's interest[38] of a right to a percentage of production. Lessees who have leased the mineral rights from the landowner and then conveyed their rights to a third party retain an overriding interest of a percentage of the oil and gas production. The situation can arise where a lessee has conveyed a lease to a third party and has reserved an overriding royalty interest. This issue appeared in *Rice Bros. Mineral Co. v. Talbott*.[39]

Talbott excludes from the definition of "owners of an oil and gas interest" under KRS section 353.620[40] those lessees who reserve only an overriding royalty interest in a conveyance which transfers the lease to a third party. The *Talbott* decision is important because all such "owners" previously had to approve the pooling agreement in accordance with KRS section 353.620. The

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[31] *See generally* SHORT, *supra* note 19, § 31.02 at 131. "There is no restriction or limitation on the shape of the unit, but failure to carefully consider the relative rights of the lessor might amount to an act of bad faith." *Id.*

[32] *Id.*

[33] WILLIAMS & MEYERS, *supra* note 1, at 777; *see also* Hall v. Fuller, 352 S.W.2d 559, 561 (Ky. 1962).

[34] 352 S.W.2d at 561.

[35] WILLIAMS & MEYERS, *supra* note 1, at 770.

[36] KUNTZ, CASES AND MATERIALS ON OIL AND GAS LAW, § 43 (1986).

[37] WILLIAMS & MEYERS, *supra* note 1, at 606.

[38] *Id.* at 450 (stating that "[a] share of the gross production of minerals free of the costs of production").

[39] 717 S.W.2d 515 (Ky. Ct. App. 1986).

[40] *See supra* note 23.

plaintiff in *Talbott* did not sign the pooling agreement and sought to receive his overriding royalty interest without reduction for pooling. This Comment examines this restricted definition and its ramifications for oil and gas lease conveyances.

I. *RICE BROS. MINERAL CORP. V. TALBOTT*

A. Factual Background

On July 15, 1979, Rice Brothers Mineral Corporation (Rice) obtained an oil and gas lease from Ross and Ruth Baker (Baker lease).[41] The lease granted exploration and production rights to approximately 150 acres in Leslie County, Kentucky. The Baker lease agreement was on a standard *Producer 88 Revised*[42] form (Standard Form) containing all normal lease provisions,[43] including a pooling clause.[44]

The lease contained two deviations from the Standard Form. The time allowed for the lease to exist without production was decreased from the normal ten years to two years,[45] and a line had been drawn through the pooling clause.[46] The lease reserved to the Bakers a one-eighth (1/8) landowner's royalty.[47]

Rice subsequently assigned all "rights, title and interests" in the Baker lease to Talbott, retaining a one-eighth (1/8) overriding royalty over and above the one-eighth landowner's royalty.[48]

Talbott drilled two wells on the property covered by the Baker lease.[49] The first well, known as T-14, did not require pooling[50]

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[41] Brief for Appellee, at Appendix A3, Rice Bros. Mineral Corp. v. Talbott, 717 S.W.2d 515 (Ky. Ct. App. 1986) (No. 85CA2727-O) [hereinafter Brief]. The assignment reserved a one-eighth (1/8) share of production from the lease. *Id.* at Appendix A1 (Baker Lease Agreement).

[42] *See supra* note 25 and accompanying text.

[43] *Id.*

[44] *See supra* note 26.

[45] Brief, *supra* note 41, at Appendix A1 (Baker Lease Agreement).

[46] *Id.*

[47] *Brief, supra* note 41.

[48] *Id.*

[49] Interview with John Talbott, Attorney for Appellee, in Lexington, Kentucky (Sept. 20, 1987) [hereinafter Interview].

[50] *Id.* (the well location met spacing requirements); *see also supra* note 16.

and was later abandoned.[51] The drilling of T-14 had fulfilled Talbott's obligation under the assignment,[52] but geologic information indicated that a site near the edge of the property was likely for a productive well.[53] However, the proposed well site was too close to the adjacent landower's property line to allow a drilling permit to be issued without pooling the adjacent tracts.[54] Talbott entered into a pooling agreement with the Bakers and the other lessors covered by the pool.[55] The Baker lease comprised sixty percent (60%) of the acreage covered by the pooling agreement[56] and would, therefore, receive sixty percent (60%) of the production.[57]

B. The Circuit Court Decision

The second well, designated T-20, proved to be productive. The Bakers and Rice were each paid royalties equal to one-eighth (1/8) of sixty percent (60%) of the well's production or 7.5 percent.[58] The Bakers accepted the royalty payments without complaint. Rice, however, filed suit in Leslie Circuit Court arguing that his overriding royalty should be one-eighth (1/8) of the well's production, not one-eighth (1/8) of sixty percent (60%) of production.[59] Rice alleged that the original lease from the Bakers to Rice, and Rice's assignment to Talbott, prohibited pooling the property; he also argued that pooling was unnecessary.[60] The court

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[51] *Id.* Interview, *supra* note 49 (less than 1 barrel per day was produced).

[52] Brief, *supra* note 41 (Talbott was obligated to drill a well before July 25, 1980); *see also* Cameron v. Lebow, 338 S.W.2d 399 (Ky. 1960).

[53] Interview, *supra* note 49.

[54] *Id.*; *see supra* note 16 and accompanying text.

[55] Brief, *supra* note 41, at Appendix A9. *See also* Rice Bros. Mineral Corp. v. Talbott, 717 S.W.2d 515, 516 (Ky. Ct. App. 1986).

[56] Brief, *supra* note 41, at Appendix A9 (Included was the provision that "In the event that Woodrow Coots retains ownership of his oil and gas rights from a lawsuit with Crats Rice, then the unit ownership will be as follows: Ross Baker - sixty (60%) percent, George Lewis - twenty-five (25%) percent, Woodrow Coots - fifteen (15%) percent.").

[57] *Id.* at Appendix A8 (stating "WHEREAS, the undersigned are the owners of royalty interest in the oil and gas in said lands and are entitled to the payment of royalties to the extent of their respective interests in accordance with the terms and provisions of said leases.").

[58] Brief, *supra* note 41.

[59] *Id.* at Appendix A-16 (complaint filed by Rice Bros. Mineral Corp. in Leslie Circuit Court) (No. 82-CI-220).

[60] Brief, *supra* note 60.

granted summary judgment in favor of Talbott, and Rice appealed.[61]

C. *The Decision of the Court of Appeals*

The Kentucky Court of Appeals, holding that Rice was not an owner of any oil or gas interest, affirmed the summary judgment.[62] Rice, therefore, was not a necessary party to the pooling agreement and was only entitled to one-eighth of sixty percent of production from the pool.

Writing for a unanimous court, Judge Gudgel distinguished ownership of solid minerals from ownership of oil and gas.[63] His opinion stated that ownership of oil and gas is "limited to possessing an exclusive legal right to explore and, if oil or gas is found, to reduce that substance to possession and ownership."[64] The court determined that the conveyance from Rice to Talbott was valid[65] and stripped Rice of all ownership interest in any oil and gas in place.[66]

The court then examined the pooling agreement, noting that "owners of all oil and gas interests in a given pool may privately give their written consent to pooling."[67] The court concluded that Rice's signature was not required to validate the pooling agreement because he was not an "owner" within the statutory meaning.[68]

Finally, the court stated: "[T]he proceeds from an oil pool in Kentucky must be apportioned according to each person's contri-

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[61] *Id.*

[62] Rice Bros. Mineral Corp. v. Talbott, 717 S.W.2d 515 (Ky. Ct. App. 1986).

[63] *Id.* at 516 (Ownership of solid minerals, such as coal entails ownership of the minerals in place and a right to explore for and produce them. Ownership of oil and gas is only a right to explore for and produce oil and gas.).

[64] *Id.* at 516.

[65] *Id.* at 517 (Unless specifically prohibited in the lease, the lessee may assign any rights possessed by virtue of that lease to a third party.).

[66] Rice Bros. Mineral Corp. v. Talbott, 717 S.W.2d 515, 517 (Ky. Ct. App. 1986) (stating that "Thus, a lessee who has assigned all lease rights and retains only an overriding interest possesses no ownership interest in any oil and gas in place.").

[67] *Id.* citing Smith v. Rogers, 702 S.W.2d 425 (Ky. 1986); KRS § 353.620 (1983).

[68] *Id.* (stating that "[a]ppellant's consent to the disputed voluntary pooling agreement, therefore was not required by KRS [§] 353.620, as it was not an 'owner' . . . within the statutory meaning of those terms.").

butions to the total production from the pool."[69] Since the Baker lease comprised sixty percent of the pool,[70] Rice was entitled to only "60% of one-eighth overriding royalty interest or 7.5% of the production of the entire well."[71]

II. ANALYSIS

In *Rice Bros. Mineral Corp. v. Talbott*,[72] the Kentucky Court of Appeals determined that one who assigns all rights, title, and interests, reserving an overriding royalty interest, is not an "owner of any oil and gas interest" within the statutory meaning of KRS section 353.620.[73] In so doing, the *Talbott* court established new law.[74]

The court, in reaching its decision, incorporated the procedural aspects of administrative pooling[75] with the statutory interpretation of the Kentucky Supreme Court in *Smith v. Rogers*.[76] In *Smith*, the Kentucky Supreme Court concluded that although the public policy of conservation[77] applies to voluntary as well as involuntary pooling,[78] KRS sections 353.630 and 353.640[79] applied

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[69] *Id.*; *see also* KRS §§ 353.510(11) (1983), 353.630(4) (1983), 353.640(2) (1983), and 353.651(2)(b) (1983).

[70] Brief, *supra* note 41.

[71] Rice Bros. Mineral Corp. v. Talbott, 717 S.W.2d 515, 517 (Ky. Ct. App. 1986).

[72] 717 S.W.2d 515 (Ky. Ct. App. 1986).

[73] *Id.* at 517.

[74] SHORT, *supra* note 19, § 31.02(c) at 129 (stating that "It is arguable than an overriding royalty interest owner takes subject to all the terms and conditions of the lease including the pooling clause and, therefore, is not a necessary party. Absent some caselaw, however, the prudent course of action is to have the overriding royalty interest owner join in or ratify the pooling declaration.").

[75] KRS §§ 353.630-353.640 (1983) (these statutes require notice to all persons owning an oil or gas interest before pooling by administrative order can commence).

[76] 702 S.W.2d 425 (Ky. 1986).

[77] KRS § 353.500 (1983) provides:

> It is hereby declared to be the public policy of this Commonwealth to foster conservation of all mineral resources, to encourage exploration for such resources, to protect correlative rights of land and mineral owners, to prohibit waste and unnecessary surface loss and damage and to encourage the maximum recovery of oil and gas from all deposits thereof now known and which may hereafter be discovered; and to promote safety in the operation thereof. To that end, KRS [§§] 353.500 to 353.720 is enacted and shall be liberally construed to give effect to such public policy.

[78] 702 S.W.2d at 427.

[79] *See supra* note 74.

only to involuntary pooling.[80] As a consequence, the statutory provisions stating that "pooling must be approved on an application to the oil and gas conservation commission, and proper notice be given to interested surface owners and a hearing held,"[81] were inapplicable to voluntary pooling agreements made in furtherance of conservation.[82]

The *Talbott* court interpreted *Smith* to mean that "owners of 'all oil and gas interests' in a given pool may privately give their written consent to pooling in furtherance of conservation, thereby bypassing the Department's notice and hearing process."[83] Such a conclusion is logical, especially when one accepts that the policy behind compulsory pooling statutes is to encourage voluntary pooling, not to provide for compulsory state action.[84]

The *Talbott* decision turned on clarification of the phrase "owner of any oil or gas interest."[85] In analyzing the phrase, Judge Gudgel implicitly limited the meaning of "ownership of oil and gas" to a right to explore for and reduce the oil and gas to possession by removing it from its natural environment.[86] His opinion also held that a lessee who assigns his interest and reserves an overriding royalty relinquishes all right to explore for and reduce oil and gas to possession.[87]

Under Kentucky law, one who holds an oil and gas lease acquires a right to explore for, and to reduce oil and gas to possession.[88] The leaseholder may convey all lease rights to a third

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[80] 702 S.W.2d at 427.

[81] *Id.* at 427.

[82] *Id.* (stating that "There would be no point or advantage to voluntary pooling that it is supposed to encourage, if the same cumbersome procedures attendant to involuntary pooling had to be met.").

[83] 717 S.W.2d at 517.

[84] 702 S.W.2d at 427, citing 38 AM. JUR. 2D, GAS AND OIL 164 (1968); KRS § 353.630(2)(b). *Smith* is distinguishable from *Talbott* because the original lease in *Smith* contained a pooling clause, while the Baker lease in *Talbott* did not. However, public policy, which encourages voluntary pooling, negates raising this distinction.

[85] KRS § 353.620 (1983).

[86] 717 S.W.2d at 517 (the court defined a lessee's rights to be a right to explore for and produce oil and gas), citing Williams' Adm'r v. Union Bank and Trust Co., 143 S.W.2d 297 (Ky. 1940); Swiss Oil Corp. v. Hupp, 69 S.W.2d 1037 (Ky. 1934); *cf.* Coleman v. Owens, 254 S.W.2d 341 (Ky. 1953).

[87] 717 S.W.2d at 517 (the court defined an assignment as a transfer of the lessee's rights to explore for and produce oil and gas).

[88] *See supra* note 86; *see also* Sellars v. Ohio Valley Trust Co., 248 S.W.2d 897 (Ky. 1952); Central Kentucky Natural Gas Co. v. Smallwood, 252 S.W.2d 866 (Ky. 1952).

party and reserve an overriding royalty interest.[89] The *Talbott* court held, however, that the conveyor was not an "owner of any oil and gas interest."[90] Therefore, in order to interpret "owner of an oil and gas interest," the *Talbott* court had to justify excluding a conveyor from exercising control over the conveyed property interest.

Since all the original lessors signed the pooling agreement, and no other conveyances were involved, the court narrowed the scope of its decision to the facts of the case. Implicit in the *Talbott* court's conclusion was its finding that an overriding royalty owner, such as an assignor, takes "subject to all the terms and conditions of the lease, including the pooling clause and, therefore, it is not a necessary party"[91] to a voluntary pooling agreement. In addition, the court held that a pooling provision is included in the lease or conveyance, even in agreements which are silent with respect to pooling.[92] Only specific prohibitions in the lease or conveyance will restrict pooling.[93]

The *Talbott* court was unable to find any precedent to justify excluding Rice from the definition of "owner of an oil and gas interest" and was forced to construct its result. The court applied the definition of "assignment" in *Coleman v. Owens*[94] to the case, and concluded that an assignee obtains all of the assignor's rights.[95] While not clearly defining "rights," the *Talbott* court cited oil and gas law as supporting the idea that "rights" referred to all rights to explore for and produce oil and gas.[96]

The *Talbott* court adopted the *Hall v. Fuller*[97] court's definition of royalty, emphasizing that a royalty interest was an interest

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[89] *See supra* text accompanying notes 39 and 87.

[90] Rice Bros. Mineral Corp. v. Talbott, 717 S.W.2d 515, 517 (Ky. Ct. App. 1986).

[91] SHORT, *supra* note 19, § 31.02(C) at 129.

[92] 717 S.W.2d at 517.

[93] *Id.*

[94] 254 S.W.2d 341 (Ky. 1953) (*Owens* involved a lease of land for loading coal, and cited cases which indicate that landlord-tenant law was applied (citations omitted)). In citing *Owens*, the *Talbott* court apparently was applying landlord-tenant law to an oil and gas lease, an application not practiced in many jurisdictions. *See* SHORT, *supra* note 19, § 25.02 at 57; *see also* WILLIAMS & MEYERS, *supra* note 1, at 412.

[95] 717 S.W.2d at 517; Bowling v. Garber, 61 S.W.2d 1102 (Ky. 1933); Cities Service Oil Co. v. Taylor, 45 S.W.2d 1039 (Ky. 1932), 79 A.L.R. 1374.

[96] 717 S.W.2d at 517, citing Williams' Adm'r v. Union Bank and Trust Co., 143 S.W.2d 297 (Ky. 1940); Swiss Oil Corp. v. Hupp, 69 S.W.2d 1037 (Ky. 1934).

[97] 352 S.W.2d 559 (Ky. 1962).

in oil and gas which has been produced.[98] Utilizing the *Owens* definition of assignments, and the *Fuller* definition of royalty, the court drew a nexus between *Owens* and *Fuller*. The court concluded that an assignment of all lease rights is a conveyance of all ownership interest in any oil or gas in place.[99] A retention of an overriding royalty interest, however, is a retention of an ownership interest in oil or gas which has been produced.[100] This conclusion is valid, because under Kentucky law, oil and gas in place is real property.[101] Oil and gas becomes personal property only after severance from its natural environment.[102]

Satisfied that the pooling agreement was valid, and basing its opinion on state statute,[103] the *Talbott* court concluded that Rice's ownership rights to produced oil and gas were limited by the percentage of property the Baker lease contributed to the pool.[104] Thus, the court based its opinion on statutes[105] which the *Smith* court had held inapplicable to voluntary pooling.[106] However, when combined with the policies behind enacting these statutes,[107] the fugacious nature of oil and gas justifies application to determine division of production.

III. CONSEQUENCES

The consequences of *Talbott* are most readily apparent in the everyday practice of drafting conveyances of oil and gas leases which reserve overriding royalties. *Talbott* may be read in two different ways. First, the decision may be holding that unless otherwise specifically stated in the conveyance instrument, the royalties from pooled wells will be apportioned according to the percentage of the pooled acreage a lease represents. Secondly, the

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[98] 717 S.W.2d at 517.

[99] *Id.* (A lessee acquires a right to explore for and produce oil and gas in place. An assignment is a conveyance of the lessor's interest.).

[100] *Id.* (A lessee who conveys his rights to a third party no longer has any rights to explore for and produce oil and gas, only a right to a percentage of production.).

[101] 143 S.W.2d 297 (Ky. 1940).

[102] *Id.*

[103] KRS §§ 353.630-353.640 (1983).

[104] 717 S.W.2d at 517.

[105] *See supra* note 74.

[106] 702 S.W.2d 425 (Ky. 1986).

[107] *See supra* note 73 and accompanying text.

decision may be read to hold that in all cases, royalties from pooled wells will be apportioned. The second interpretation, however, runs counter to the inherent right of parties to contract. Assuming the first interpretation to be correct, the question remaining after *Talbott* is: how can a royalty owner protect his royalty rights?

CONCLUSION

Pooling is a necessary and encouraged practice.[108] Inherent in the power to pool is the power to apportion the pooled property, with each property in the pooled unit contributing and receiving from the unit proportionate shares.

Rice Bros. Mineral Corp. v. Talbott sets precedent by holding that an overriding royalty owner is not an "owner of an oil and gas interest," and therefore, is not a necessary party to a pooling agreement.[109] This decision increases the importance of carefully drafting the documents conveying oil and gas interests. The *Talbott* decision implies that pooled property will be apportioned in all cases, unless the instrument conveying the oil and gas interests restricts the power to apportion. Therefore, it appears that a conveyor's only protection is to defensively negotiate and draft conveyance agreements.

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[108] *See supra* notes 17 and 18 and accompanying text (conservation and economics).
[109] 717 S.W.2d 515 (Ky. Ct. App. 1986).