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October 24, 2013

Via Hand Delivery
Examiner Richard Atkins
Examiner Marshall Enquist
Railroad Commission of Texas
1701 N. Congress, 12th Floor, Rooms 145G and 145E
Austin, Texas 78711

In Re: Oil & Gas Docket No. 01-0278952; The Application of EOG Resources, Inc. for its Klotzman Lease (Allocation) Well No. 1H, Eagleville (Eagle Ford – 2) Field, DeWitt County, Texas as an Allocation Well on Acreage Assigned from Two Leases

Dear Examiners:

Enclosed for filing in the above-referenced docket is the original and 14 copies of EOG Resources, Inc.'s Reply to Motion for Rehearing. Please file-stamp the extra copy and return it to us via our awaiting messenger. We also enclosed a copy of this motion on CD.

Thank you for your assistance. Please call if you have questions or need anything further.

Respectfully submitted,

Doug J. Dashiell
Attorney for EOG Resources, Inc.

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Encl.
c: Service List

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OIL AND GAS DOCKET
NO. 02-0278952

APPLICATION OF EOG RESOURCES, INC., KLOTZMAN LEASE (ALLOCATION) WELL NO. 1H, EAGLEVILLE (EAGLE FORD - 2) FIELD, DEWITT COUNTY, TEXAS (STATUS NO. 744730)	§ § § § §	BEFORE THE RAILROAD COMMISSION OF TEXAS OFFICE OF GENERAL COUNSEL

EOG RESOURCES, INC.'S REPLY TO MOTION FOR REHEARING

TO: THE HONORABLE RAILROAD COMMISSION OF TEXAS:

COMES NOW EOG Resources, Inc., ("Applicant" or "EOG") and files its reply to the motion for rehearing of the Protestants Katherine Larson Reilly and Melanie McCollum Klotzman (hereinafter "the Klotzmans") and would respectfully show the Commission the following:

I. Introduction

The Klotzmans have filed a lengthy motion for rehearing in this case reurging many of the same arguments that the Commission has considered and properly rejected. The Klotzmans' motion raises no material issues of fact or law and the motion should be denied.

The Klotzmans' motion is loosely framed around the erroneous claim that the Commission's order is invalid based on two distinct arguments.

The first such argument is that the permit allegedly violates existing Commission Rules 40 and 26. Rule 40 addresses pooled units and is inapplicable to this case since EOG has never pooled or attempted to pool of the Klotzmans' land and the Commission's order does not purport to pool anything. The Klotzmans' motion attempts to bootstrap an alleged violation of Rule 40 by assuming, contrary to the facts and law that the Commission's order granting a drilling permit to EOG is somehow the equivalent of pooling. Equally erroneous is their contention that the issuance of this drilling permit violates Rule 26, the Commission's rule regulating "separating devices, tanks, and surface comingling of oil," none of which are at issue in this case.

The Klotzmans' second argument simply reargues their claim that EOG lacks a good faith claim to title despite the undisputed evidence in this case that establishes that EOG and its working interest partners hold record title to oil and gas leases covering 100% of the mineral estate in both tracts traversed by the well. The Klotzmans continue to confuse the issue of whether EOG has adequate title to drill (which it does) with the issue of whether EOG's leases give EOG pooling authority (which they do not). EOG has more than satisfied the standards established by the Texas Supreme Court requiring a "reasonably satisfactory showing of good faith claim of ownership in the property." *Magnolia Petroleum v. Railroad Comm'n,* 170 S.W.2d 189, 191 (Tex. 1943).

After lecturing the Commission that its order is "unencumbered by reasoning, support, or justification" and that "the Commission is bound by its own rules," the Klotzmans' motion implicitly argues that the Commission has no authority to issue any allocation permit without adopting new rules or amending existing rules to meet the Klotzmans' desired requirements for new forms and procedures to govern them. However, the record in this case reflects that the Commission staff has established procedures and forms it utilizes for processing allocation permits and EOG has fully complied with the Commission requirements for an allocation well drilling permit. But for the protest the permit would have been issued administratively, just like the numerous other allocation permits the Commission has approved over the past 3 ½ years. The Commission is bestowed with broad statutory authority to regulate oil and gas wells. "When an administrative agency is created to centralize expertise in a certain regulatory area, it is to be given a large degree of latitude in the methods it uses to accomplish its regulatory function." *City of El Paso v. Public Utility Comm'n of Texas,* 609 S.W.2d 574, 579 (Tex. App. – Austin 1980, writ ref'd n.r.e.).

II. Argument

EOG's drilling permit does not violate Commission Rules.

The Klotzmans' Rule 40 argument lacks merit. The title of Rule 40 "Assignment of Acreage to Pooled Development and Proration Units" accurately describes its scope. Despite conceding

that Rule 40(a) provides only that an operator "may pool acreage" to create a drilling unit, the Klotzmans seek to make this permissive rule mandatory to require that operators must pool to drill across their separate leases. Nothing contained in Rule 40(a) or anywhere else in the governing statutes or Commission rules requires the formation of pooled units to obtain a drilling permit. The Klotzmans are correct that when pooled units *are* formed, Rule 40 prescribes the use of Form P-12 to provide the information described in the rule. EOG has never claimed authority to pool the Klotzmans' interest and the Klotzmans' Rule 40 arguments are entirely misplaced.

For several years, the Commission staff has utilized Form PSA-12 for permitting both production sharing agreement and allocation wells. EOG has correctly applied for its Klotzman 1H permit using the PSA-12 Form which lists the tracts crossed by the well, the acreage in each tract and the acreage allocated to the well. *See,* EOG Exhibit 1. Clearly, the Railroad Commission's broad statutory jurisdiction gives it the flexibility to determine which forms should be utilized by operators for permitting different types of wells.

The Klotzmans' Rule 26 arguments are equally misguided. Rule 26, entitled "Separating Devices, Tanks, and Surface Comingling of Oil" governs, as the title suggests, "surface comingling." No surface comingling is involved in this case whatsoever. The specific provision the Klotzmans' claim is violated is contained in Rule 26(a)(2) which requires that "all oil and any other liquid hydrocarbons *as and when produced* shall be adequately measured according to the pipeline rules and regulations of the Commission *before the same leaves the lease from which they are produced* . . . ." (Emphasis added). The Klotzmans, ignoring the plain meaning of these words, argue that this rule is really meant to prevent downhole migration from "the non-surface location lease" to the wellhead where the surface location is located. The rule quite clearly requires measurement "as and when produced" and prior to the time the oil leaves the lease "from which they are produced." Oil or gas has been held to be "produced" when it is physically severed from the soil. *Exxon v. Middleton,* 613 S.W.2d 240, 242 (Tex. 1981). In the context of Rule 26,

governing surface commingling and measurement, the requirement to measure production means measurement of oil or gas that has been severed and removed from the well at the surface. This "production" will occur at the surface location of the well located on the Georgia – Dubose Pierce Lease, not downhole within the Eagle Ford formation as the Klotzmans argue. EOG will properly measure any oil or gas produced from this well prior to the time that the oil leaves the lease on which it is produced as the rule requires. Rule 26 does not and was never intended to address the downhole comingling scenario described by the Klotzmans. EOG does not, as the Klotzmans argue, seek to "exempt itself" from Rule 26 or any other Commission rule. It intends to fully comply with these rules.[1]

The Commission's order correctly recognizes EOG's good faith claim to title.

As the parties have briefed exhaustively in this case, the controlling issue is whether or not EOG has a good faith claim to title. Since it is undisputed that EOG's leases covering 100% of the mineral estate in both tracts and are in full force and effect, this issue was never seriously in dispute in this case. The leases grant the lessee a fee simple determinable estate in the minerals. The Klotzmans seek to make the leases an issue by confusing the issue of title with the issue of whether lease contracts allow for pooling.

EOG's documentary evidence and testimony as to its good faith claim to title is clear in this record. The oil and gas leases themselves (EOG Exhibits 9 and 10) cover 100% of the mineral estate. EOG's testimony is that EOG and its working interest partners together own the leases covering 100% of the mineral estate of each tract traversed by the wellbore. (TR. 39, l. 12 – 17).

[1] The Klotzmans further argue by footnote that "even if one were to arbitrarily classify what EOG proposes to do as 'downhole comingling,' it would 'technically be prohibited' by Statewide Rule 10 because of the fact that it crosses the DeWitt – Gonzales County line and produces from two Commission designated fields." The two fields, Eagleville (Eagle Ford – 1), and Eagleville (Eagle Ford -2) consist of the identical geologic strata and, in fact, are defined as the identical interval in the same well (EOG's Milton Unit No. 1 in Karnes County). The Eagle Ford has been established as separate "fields" by district solely for administrative convenience and no downhole comingling of separate strata is proposed in any logical sense. It is extremely doubtful the Commission would require a Rule 10 exception simply because a well crosses district lines. Regardless, compliance or noncompliance with Statewide Rule 10 is not an issue in a drilling permit application, but at the completion stage of a well and such a well would easily satisfy all requirements for a downhole commingling permit.

EOG has never claimed that EOG alone has current record title to 100% of the working interest in these leases. That issue is totally irrelevant to this application. EOG submitted its Term Partial Assignment of Oil and Gas Leases (EOG Exhibit 12) which clearly describes EOG's ownership of an undivided 70% of the leases, with the remaining 30% being retained by EOG's working interest partners, the Assignors listed in Exhibit 12. EOG accurately represented on its initial application and throughout this case that EOG is the operator of the leases and "EOG has all necessary real property and contractual rights to drill and produce the applied for well and the legal right to develop and produce the minerals under all acreage assigned to the well." EOG Exhibit 1. Neither the Klotzmans nor anyone else besides EOG and its working interest partners have any rights whatsoever to drill these leases in the Eagle Ford formation. The Commission has correctly recognized these facts in its Final Order. Substitute Finding of Fact 4 adopted by the Commission provides that "EOG is the operator of and owns 100% of the working interest rights" to the Eagle Ford within these leases. The Klotzmans have seized upon the technicality that EOG actually owns title to 70% of the working interest rights and has contractual rights to the remaining 30% to argue that Substitute Finding of Fact 4 is inaccurate. The undisputed record shows that EOG operates and with its working interest partners own 100% of the leasehold estate. To the extent the Commission's current Substitute Finding of Fact 4 is partially inaccurate, EOG suggests this matter be addressed with a revised substitute finding of fact that states:

Substitute Finding of Fact

> No. 4. EOG is the operator of and, together with its working interest partners, owns 100% of the working interest rights to the Eagleville (Eagle Ford – 2) Field interval under the Georgia Dubose – Glassell 516.569 acre lease and the Georgia Dubose – Pierce 304.97 acre lease and there are no unleased interests within 330 feet of any point on the proposed wellbore.

The Klotzmans' Surface Use Argument is Wrong

The Klotzmans next claim that EOG lacks authority to drill and operate the proposed well without pooling due to a conspicuously incorrect surface use argument. The motion states "absent

pooling of the two tracts, or some explicit authority obtained from the owner, the operator has no authority to burden the drillsite tract with operations that are conducted to facilitate production from the nondrillsite tract." MFR at Page 15. EOG first observes that this issue is entirely a matter of contract law and a dispute outside of the Commission's jurisdiction. However, if the Commission were to inquire into this issue, it would find in the record of this case that EOG does have, in its oil and gas lease, the "explicit authority obtained from the owner" that the Klotzmans argue is necessary to produce the well. The surface location for the proposed well is located within the boundaries of EOG's Georgia Dubose – Pearce Lease (EOG Exhibit 9). The granting clause of that lease expressly grants to the lessee rights to the surface "necessary or useful in lessee's operations in exploring, drilling for, producing, treating, storing, and transporting minerals produced from the land covered hereby *or any other land adjacent thereto*." The proposed Klotzman 1H Well is to be drilled on both the Georgia Dubose – Pearce Lease and the Georgia Dubose – Glassell Lease which covers land "adjacent" to the Georgia Dubose – Pearce Lease. Without agreeing with the Klotzmans' contention that any such express authority is necessary, EOG's lease does, in fact, provide this express authority and Klotzmans' surface use arguments are erroneous.

The Smith Letter

The Klotzmans' 27 pages of argument raise and rehash various other issues that have been exhaustively argued in this docket. For example, the Klotzmans' dedicate approximately four pages to their creative interpretation of selected portions of Professor Ernest Smith's July 23, 2009 letter, admitted as evidence in a previous Haynesville field rules hearing and now in the record of this case. The pivotal fact of the Smith letter that is germane to this hearing is that the well discussed in the Smith opinion traversed more than one pooled unit and therefore, was drilled across property lines without pooling in the same way that the Klotzman No. 1H Well is proposed to be drilled. Regardless of the other issues addressed by Professor Smith in that case, his opinion

that the allocation well in the Haynesville hearing was proper is squarely on point for the Klotzman well and the Smith letter fully supports the Commission's decision in this case.

The *Browning* Case

The Klotzmans dedicate a significant portion of their argument to the case of *Browning Oil Co., Inc. v. Leucke,* 38 S.W.3d 625 (Tex. App. – Austin 200, writ denied). The *Browning* case is closely on point because it involved a horizontal well drilled by Browning across multiple tracts that the Court determined had not been validly pooled. The Court in *Browning* did not, as the Klotzmans argue, broadly hold that the drilling of such a well "violated the terms of the lease." Instead, the *Browning* Court held that Browning's attempts to pool the Leuckes' land violated the pooling clause of the lease. 38 S.W.3d at 643 ("We hold that the trial court did not err in ruling that the Lessees failed to comply with the pooling provisions of the leases"). Nowhere in the *Browning* decision does the Court hold that a lessee has no right to drill a horizontal well traversing multiple leases in which the lessee holds a leasehold, unless the leases have been validly pooled. The *Browning* Court also correctly observes that drilling a horizontal well across multiple leases is the legal equivalent of drilling a separate well on each one of the adjoining leases, and that lessors are entitled to recover royalties based on a determination of what production can be attributed to their own tracts with reasonable probability. 38 S.W.3d at 647. This holding is the antithesis of pooling, as the court clearly recognized that such a horizontal well does not pool separate tracts, and the owners of each separate tract are limited to royalty on the share of production attributed to their own land, rather than an allocated share of production from a unitized area that would result from pooling.

Klotzmans' request for oral argument.

The Klotzmans' motion asks for oral argument. Although EOG would certainly participate if the Commission has an interest in hearing oral argument, the facts of the case are not disputed and the legal issues have been thoroughly briefed in exceptions, replies to exceptions, a motion for

rehearing, replies, and other post-hearing filings. EOG requests that the Commission deny the request for oral argument.

III. Conclusion

The Klotzmans' motion for rehearing raises no new facts or legal issues that would merit a reconsideration of the Commission's order. EOG requests that the Commission revise its Substitute Finding of Fact No. 4 to reflect the undisputed facts that EOG and its working interest partners own and EOG operates 100% of the minerals in the field under both leases in this case and EOG has the right to develop 100% of the minerals in this field interval under both leases.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing has been served on all counsel of record, in the manner indicated below on the 24th day of October, 2013.

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